MR MIDDLETON

cc Mr Burns
Mr Bridgeman
Mr Britton
Mr Cassell
Mr Unwin
Mr Riley
Mrs Stamler
Mr Powell

Mr S P Collins (Bank)

SELECT COMMITTEE: MINFORD

I attach a note by Stephen Collins of the Bank on Patrick Minford's appearance yesterday before the Select Committee, together with some press clippings. The note brings out clearly the general approach adopted by the Committee and their main lines of attack. Minford defended his position solidly and as usual showed few signs of hesitating to go onto the counter-attack. He was clearly facing a hostile and sceptical group and on at least two occasions chose to accuse them of acting irresponsibly in making suggestions that the Government might (or should) at some stage change their stated policies.

2. As Collins' note points out, du Cann and other members harked back frequently to their last report and the need to get more detailed forecasts from HMT on elements of the PSBR projections. At times they seemed to be concentrating more on the implications of policy for the PSBR than for the management of the economy.

3. The Committee gave the impression of having been well briefed on an individual basis and the procedure of giving each of the first three interlocutors (Higgins, Bray and Baker) an uninterrupted 15 minutes provided a good basis for detailed questionning. However, any attempt they may have made to co-ordinate their questions in advance was not wholly successful. It seemed to me they wasted too much time on asking repeatedly about matters on which Patrick couldn't be expected to be an expert - the response of Trade Unions, the setting of "cash limits" for Nationalised Industries - and too little on the issues of evidence and costs. Nevertheless, having sat through a good many Congressional hearings over the last couple of years,

but not previously having seen a Commons Committee in action, I found the session refreshingly free of attempts to play to the gallery and much more prepared than its American counterparts to tackle intellectual problems.

4. The Committee concentrated more on the questions of how current policy should be carried out and what its costs were likely to be than on what alternatives might be available. There were several questions on what PSBR objectives were needed to support the monetary target (including references to the City University paper), but none on whether the right figures had been chosen for the £M3 target. A query put several times by Terence Higgins was how a tight monetary policy differed from "old-fashioned deflation". The exchange rate was proferred a couple of times as an additional objective, but only Jeremy Bray went into the theoretical potential for successful stabilisation policy, quoting Lucas and Sargent against Minford. There were no questions on the stability of the demand for money, or on evidence of the link between monetary growth and inflation or on details of the transmission mechanism itself.

5. A few less obvious questions did creep into the examination. Baker queried the short-term outlook in detail, variable by variable. Higgins asked about the effectiveness and PSBR-cost of the ECGD's activities. Bray suggested that monetary policy simply shifted instability from the money supply to the exchange rate and thus put the burden onto exporters and importers. Sheldon claimed that the best way the Government could show it meant action on credit and inflation was to impose direct controls. That would also transfer the cost from possibly advantageous public investment (otherwise cut because of the PSBR constraint) to less vital consumers' expenditure. Finally, Bray was allowed to query whether the 1979 budget switch between direct tax and VAT really had no impact on inflation.

Jon Shields

JON SHIELDS
1 July 1980

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NOTE FOR RECORD   Copies to Mr Fforde Mr Goodhart Mr Foot
Mr Dow Mr Holland Mr Midgley
Mr Loehnis Mr Walker GPS
Mr Flemming Mr Dicks-Mireaux DGPS
Mr George Mr Quinn

SELECT COMMITTEE: ORAL EVIDENCE

1 The Select Committee examined Patrick Minford for about ninety minutes yesterday afternoon, this being the first session of oral evidence in their monetary policy enquiry. The proceedings were recorded by the BBC*. Journalistic attendance was reasonable, although the Committee room was by no means full. Advisers present were Budd, Hendry and Miller; they were consulted hardly at all. Minford's replies reflected the extreme views set down in his written submission. The purpose of this note is to give some impression of the issues which appeared particularly to interest MPs, and which might prove relevant to forthcoming appearances by Bank witnesses; accordingly, more attention is paid to the questions than to Minford's replies.

2 MPs' questions covered in an unstructured manner a good part of the questionnaire, and also referred on more than one occasion to an article published by Minford in "The Banker", July 1979. There was a tendency to hark back to the Committee's second report (on the Budget and public expenditure White Paper) - see paragraph 10 below. The majority of questions were asked by Higgins, Bray and Baker, although all members present were given a say (there was not a full house, however - Shepherd, Wainwright and Woolmer were absent). One was left in little doubt that the Committee did not share Minford's optimism about the outcome of present policies.

3 The main issue concerning <u>Terence Higgins</u> was to try to discover how the present monetary policy differed in its impact on wage negotiations from old-fashioned deflation as used in the days of "stop-go". Is it not the case that inflation will be slowed by falling aggregate demand, caused by adherence to restrictive monetary

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* Apparently to be broadcast in part in a Sunday evening programme which specialises in the proceedings of Select Committees /"Inside Parliament"?/.

targets? Minford denied that falls in demand and output were an inevitable and necessary part of present policy, and suggested that they would be absent if all concerned believed the Government's policy announcements and acted accordingly. A second issue raised by Higgins was, rather surprisingly, that of export credit subsidies: are they not an illogical feature of policy - effectively adding a premium to the price of foreign exchange - in an era of floating exchange rates? Minford agreed, but, in response to a further question, doubted whether their removal would materially affect the ability to achieve monetary and PSBR targets.

4 Jeremy Bray predictably made some remarks about Minford's economic model and the application of optimal control techniques. It was eventually agreed to conduct further dialogue on these subjects in written correspondence. He also, however, raised a few points of more general interest. In contrast to reports of his behaviour at the Chancellor's appearance last week, he asked his questions quietly and sensibly, although gently chiding the Treasury at one point for the lack of empirical content in their response to the questionnaire. Bray doubted whether it was necessary to know exactly where high-employment, non-accelerating-inflation equilibrium was in order to conduct stabilisation policy; so long as one knows the direction in which one wishes to move, that should be sufficient. Minford strongly disagreed for the reason, inter alia, that any relaxation of policy for anti-cyclical stabilisation would impede the formation of correct expectations about Government policy by the private sector. Bray's second point was that it is naive to assert that for a policy to be credible it must be simple; for if it is too simple - which he interpreted as meaning rigid - it would in fact appear fragile and susceptible to a U-turn. His final point was that adherence to a monetary target shifts instability into the exchange rate, and that this can itself entail severe costs to the private sector, which are not necessarily fewer than those which fluctuating monetary growth would impose.

5 Kenneth Baker questioned Minford closely about the forecasts contained in his submission. Baker said that Minford's forecast was the most optimistic seen by the Committee, and that therefore

the validity of his case depended on the accuracy of that forecast - a *non sequitur* emphatically disputed by Minford. Despite this dubious logic, Baker scored some telling points against the optimism of Minford's forecast. His main concerns were clearly with the short-term outlook for the economy, rather than with theoretical niceties. He wanted to know Minford's forecasts for unemployment, inflation and manufacturing output next year; what can be done to help Merseyside (the location of Minford's university - Liverpool), and whether Minford's proposed policies of lower unemployment benefit and lower real wages would be socially acceptable to Merseysiders; and whether Minford honestly believed that wage negotiations in the public sector should be left totally free from Government interference.

6 *Robert Sheldon* only asked one question: what happens if the unions disbelieve the signals contained in the Government's monetary strategy? Minford's response was equally simple: they would be making a great mistake.

7 *Tim Eggar* asked a number of different questions. The most significant was derived from the assertion in Friedman's evidence that the PSBR *per se* is not necessarily of great significance for the development of the money supply; Eggar supplemented this by reference to the paper by Middleton et al., submitted by the Treasury (and referred to in our evidence), which shows that the relation between the PSBR and the money supply varies according to the composition of the former. Minford argued, by contrast, that the PSBR is of critical importance, being the major source of new financial assets in the economy.

8 *Anthony Beaumont-Dark* claimed in a single intervention that we do not have a free exchange rate because of Bank intervention - and, by implication, that this was a bad thing. Minford agreed.

9 *Michael English* made one or two points worth noting amid some confused and confusing questions. He seemed to think that we do not monitor enough monetary aggregates (unlike the Fed), and that we are inhibited from so doing because, for example, building society statistics are collected for a different period from banking figures. He also argued that it was perfectly possible to

depress the exchange rate without unduly increasing the money supply simply by imposing a Swiss-type negative interest rate on monetary inflows. Again drawing on the American parallel, he asked whether the direct controls recently imposed in the USA were responsible for the rapid fall in interest rates. He was clearly of the view that they should be considered as a strong counter-inflationary weapon wholly in tune with Minford's desire to see clear policies introduced to that end. Minford agreed that they hit hard against inflation, but said that they introduced undesirable distortions.

10 The Committee's critical recent report on the Budget and expenditure White Paper was clearly to the forefront of several members' minds. Edward du Cann's interventions were almost wholly directed to reminding Minford of the doubts expressed in the report about in particular the expenditure projections underlying the PSBR targets - especially as regards nationalised industries and the housing programme. English complained that the Chancellor had admitted to the Committee that the Treasury did not even know the details underlying these projections. Minford responded robustly that that was a perfectly tenable position, quite consistent with the ultimate achievement of the PSBR targets. Also taking up earlier themes, Eggar asked whether Minford thought the Government is making enough information available to assist in the formation of expectations. Minford seemed quite content with what was forthcoming from the Treasury.

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11 It will be apparent that limited time prevented any issues from being explored in great depth, and it is not possible to draw any clear lessons for the Bank's forthcoming appearance. But certain observations may be worth making. Some MPs clearly have hobby-horses on which questions can be expected in the future. Bray's are well known, but it would not seem difficult to steer technical econometric questions into subsequent written exchanges - certainly, du Cann seemed eager to encourage this. Du Cann himself appears to be excessively concerned to reiterate points made in the Committee's last report. Baker is likely, on this showing, to explore our views about economic prospects this year and next. English appears intent on pressing his view that more direct methods

of monetary control are desirable. But if one thing emerges above all, it is that MPs will feel themselves free to range over a very wide area indeed, and question-spotting might well prove to be a very hit-and-miss affair.

Economics Division
1 July 1980

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SPC

Daily Papers 1st July 1980

GUARDIAN

Economist gives evidence

By Christopher Huhne

Professor Patrick Minford of Liverpool University, one of Britain's leading monetarist economists, yesterday called for cuts in unemployment pay and the removal of the "monopoly powers" of trade unions in order to reduce unemployment.

The professor, who was giving evidence to the House of Commons Treasury and Civil Service Committee, said that there was nothing in the setting of monetary targets which ensured high unemployment. If workers adjusted their expectations of inflation and their wage demands to monetary targets, the transitional cost of the policy in lost output and unemployment would be negligible.

The professor said that people who suggested that the Government would do a U-turn did Britain a great dis-service, because it would make the loss of output and worsening unemployment more severe.

The Treasury committee recently produced a report which cast doubts on many of the assumptions behind the Government's strategy, and which was particularly sceptical of the projected £2 billion turnround in nationalised industry's finance. But Professor Minford maintained that these were merely "details."

In questioning by Mr Kenneth Baker MP, the professor admitted, however, that his view of the economy, which assumes that workers will adjust quickly in cutting real wages, had become more pessimistic since his last forecast in March.

Where he had predicted zero growth, he now expects a three-quarter per cent decline in total GDP, though a larger fall in manufacturing output. Inflation would still be about 16½ per cent at the end of the year, but unemployment would rise to 1.75 million, and to 1.9 million at the end of 1981.

Professor Minford denied, though, that the changes in any way undermined the validity of his policy prescriptions. Every economic forecast had become more gloomy due to the deterioration in the world economy, particularly in the United States.

Despite this deterioration, Professor Minford rejected any Government policy to stabilise the level of demand. This was not, he said, because it was not feasible, but because any Government error could compound the situation, and expectations would be adversely affected.

TIMES

Warning against early interest rate cuts

By John Whitmore

A warning to the Government that it should not lower interest rates prematurely came yesterday from Professor Patrick Minford, a leading monetarist economist, in evidence to the House of Commons Treasury and Civil Service committee.

Professor Minford, of Liverpool University, told the committee that lower interest rates would not be appropriate until there was firmer evidence that the money supply was under control. He suggested that the Government should aim at the lower end of its 7-11 per cent target for the annual growth rate in sterling M3.

He said a premature cut in interest rates might lead to a fresh upsurge in credit demand and make it much more difficult to control the monetary aggregates. He felt the present policy mix on public sector borrowing, monetary targets and interest rates was probably about right, although he would have preferred to have seen a public sector borrowing target some £1,500m lower in the present financial year.

He regretted the Government had not taken a firmer grip on the PSBR and monetary growth during its first six months in office.

Until wage negotiators accepted the implications of the Government's monetary policy, excessive wage awards would inevitably mean a loss of jobs. As long as the Government maintained its present monetary aims, speculation of a U-turn was irresponsible and could lead wage bargainers into making mistakes.

A tight monetary policy need not in itself lead to a loss of jobs, provided people understood the limitations imposed by that policy. He differentiated between the loss of jobs arising from monetary policy itself and from the world recession, which was deepening more quickly than expected.

He emphasized, however, that the present level of unemployment in the United Kingdom was largely the result of an excessive level of real wages. He suggested that trade union power should be weakened and that levels of unemployment benefit were too high.

Professor Minford advocated progressive reduction of public sector borrowing. A policy of using the PSBR as a stabilizer in recession could lead to confusion and cause uncertainty among wage bargainers about "sensible" expectations.

The committee will continue to hear evidence on monetary policy during the next few weeks, including evidence from Sir Geoffrey Howe, the Chancellor of the Exchequer and Mr Gordon Richardson, the Governor of the Bank of England.

Financial Times

onetary policy defended

By Peter Riddell, Economics Correspondent

BEWILDERMENT and incomprehension resulted yesterday when Parliamentary sceptics about the workability of the Government's reliance on monetary policy came face to face with a true believer whose firmness of faith might occasionally raise doubts even among Treasury Ministers.

Professor Patrick Minford of Liverpool University gave evidence to the all-party Treasury and Civil Service Committee of the Commons at the start of the series of public hearings which it is holding on the conduct of monetary policy between now and the end of July.

Profesor Minford provided an eloquent defence of the need to publish medium-term monetary targets in order to influence the attitudes of pay bargainers and others operating in the economy.

He said that the key task was for these people to accept the credibility of the targets. Then it should be possible to reduce inflation without unnecessary loss of output or jobs.

Professor Minford said that mistakes such as higher unemployment would occur if participants in the economy such as pay bargainers did not have full information about the Government's intentions.

That was why it was necessary for opinion formers such as MPs on the committee to convince the public that there would be no U-turn in economic policy.

Prof. Minford's comments were received with evident scepticism by some members of the committee including various Tory MPs.

In particular, Mr. Kenneth Baker, a minister in the Heath Administration, strongly questioned Prof. Minford's theories on the basis of his forecasting record. Mr. Baker questioned whether the Professor had been too optimistic earlier this year about the prospects for the economy.

Prof. Minford said that expectations about output had been revised downwards since March because of the world recession, but he said forecasts as such should not determine the acceptability or otherwise of his theory.

Prof. Minford said he expected that total output in the UK would fall by three quarters of a per cent this year compared with 1979 and that unemployment would rise to one and three quarter million by the end of this year

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Telegraph

sion funds and insurance companies will not mind too much, particularly as the company appears to be doing very well at present.

Rational expectations

THE Treasury Committee's Grand Tour of monetary policy yesterday moved from the brochure stage to the first port of call with a session of oral evidence from Professor Patrick Minford of Liverpool University. Minfordia does not seem to be a place in which the committee wants to spend much time, which is a pity, but it was well worth giving the rational expectations version of monetary economics a hearing.

In Patrick Minford's view, as in that of the London Business School the Treasury Committee has missed the point in criticising the detail of the Government's for lack of credibility. How medium-term financial plan for lack of credibility. How the Government's monetary targets are achieved is far from being unimportant. But the principle of making them at all deserves more consideration than the committee has so far given it.

To an economist who believes that economic decisions, including pay bargains, are made on the basis of rational expectations about the future, including future inflation, there is every argument for the Government spelling out its intentions as firmly and as fully as it can. The most important thing, if intentions can be believed, is to know where the Government intends to get to in terms of its monetary policy and its inflation objective. How it gets there will depend on circumstances at the time.

Professor Minford argues that given the gap between where we are now and where we want to get to it would be unwise for the Government to allow the natural increase in the public sector borrowing requirement arising from a recession to take place. He also approves the Government's determination to keep interest rates high until there is clearer evidence that monetary growth is under control.

One of the more thought provoking exchanges in what sometimes threatened to become a dialogue of the deaf was Professor Minford's assertion that firm monetary policies, if properly and publicly planned, were not necessarily "deflationary" in the conventional sense of the word. If wage bargainers and others adjusted their behaviour to reflect future monetary targets there need be no loss of output or jobs.

In general, however, the questions not asked were more interesting than those that were. For instance, if expectations about the future are all important should not the Government publish its forecasts of interest rates?

Behind those bank profits

IN A FEW WEEKS time the big four High Street banks will be announcing something like a 25 p.c. rise in profits to a total of £900 million before tax for the first half of 1980. In the present circumstances, it is not hard to imagine how this news will go down