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PRIME MINISTER

WHY DO WE HAVE 8 PER CENT INFLATION?

You may like to see Professor Budd's analysis of what has gone wrong with economic policy, if only because Terry Burns' own analysis would be very similar. Like Tim Congdon, Alan Budd sees the difficulties beginning in 1985-86, long before the shadowing of the DM, though that gave things an extra push by causing the signals coming from MO in early 1988 to be overridden.

Although in the long run, Alan Budd is sympathetic to the ERM, he wishes to stick with MO targets for the time being, but with broad money being given greater emphasis than in the recent past.

It would be helpful to ask the Chancellor for a paper giving his own analysis of events. First, this would counteract his tendency towards secrecy and would reduce the risk that you and he get at cross purposes. Secondly, it would provide a basis for discussing a number of unresolved issues, e.g.,

- narrow ~~the~~ broad money targets, and whether any weight can be put on the apparent return to trend of M3 velocity, see Alan Budd's figure 7;
- the effect of intervention when sterilised.

Thirdly, it would also help bring the Chancellor to acknowledge that mistakes have been made over a number of years without pinning them on factors which are attributable to him alone. There have been mistakes of Government, but since you have consciously strengthened the position of the Treasury

- by eliminating other sources of advice such as the CSD and CPRS;

- by discouraging second guessers in the Harold Lever role

the Treasury does have to take responsibility when things go wrong as well as take credit for the successes.

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22 May 1989