Public Talks

Monetarism – and Howe?

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Tonight, as my title implies, I shall be concerned with that borderland between theory and practice where, in the battle for political supremacy, the policy implications drawn from economic theory are all too often ranged with lies, damned lies, and statistics.

This present government was elected to office with a known commitment to monetarism – that is, to policies derived from the theories of a particular group of academics led by Professor Milton Friedman.

Its adherence to monetarism led it to believe that inflation could be squeezed out of the system by restricting the rate of increase in the money supply, and that whilst this squeezing out process would be associated with some temporary rise in unemployment, in the longer run, within the usual lifetime of a Parliament, output and employment would return to its 'natural' level.

The public commitment to monetarism is now known as the Medium Term Strategy, and according to Professor Ball, Principal of the London Business School, it is derived from the proposition that in the medium term both monetary expansion and monetary restriction are largely dissipated in price changes with little or no medium term effect on output and employment.

To avoid the emotionally charged judgements inevitably associated with political accusations and counter-accusations the view I shall be describing tonight is from a vantage point firmly centred on theory – the theory behind Professor Ball's proposition – the restated quantity theory of money.

In reviewing the past eighteen months I will accept that the government have a medium term strategy, and I will also accept

Professor Ball's contention that the consequences of that medium term strategy have yet to be seen. I will accept that the evidence of eighteen months is too short a time to support or reject the basic monetarist proposition formulated by Professor Ball.

My concern will be with whether the Chancellor's activities during the past 18 months have been conducive to the successful carrying through of the government's medium term strategy – whether they have been consistent with the policy implications to be drawn from the restated quantity theory of money – and also, whether the theory itself accurately predicts the results, so far, of the Chancellor's actions.

What requires explanation is the fact that this country, although near self-sufficient in energy supplies and with a strong currency (a uniquely powerful position amongst the developed nations of the world), with this great economic advantage, is suffering from the present world recession much more than any other of the less fortunate industrialised economies. Are our present difficulties a necessary passing phase? Are they, perhaps, the inevitable result of monetarist policies?

I will be arguing that the government is not keeping to its post-election medium term strategy; that a slump is unnecessary; that there is a growing danger it will not be a passing phase; and that all this is not so much due to the government's public commitment to monetarism, but rather, the inevitable result of its pursuing ill-timed misconceived policies drawn not from the restated quantity theory of money, but from other theories and from widely accepted economic mythologies.

In the realm of politics the government of the day is blamed for everything that goes wrong, and in politics this is fair play – the government of the day may also claim credit for everything that happens to go right. But from a standpoint of economic theory we must be more discriminating.

From the economic point of view this government cannot be blamed for over two million unemployed. Full employment did not

cease suddenly in May 1979. To the contrary, the evidence shows that unemployment in this country has been on a rising trend for more than 25 years, and that between 1955 and 1979 the numbers registered as wholly unemployed multiplied some nine times.

Again, if we are to make an economic assessment of this government's record on unemployment we must take into account the well established time lags. E.S.A. research indicates that it takes some twelve months for a change in employment taxes to be fully reflected in the unemployment figures, whilst Professor Friedman argues that it takes some eighteen months for a change in monetary policy to significantly affect the volume of output and employment. From all this we must conclude that Sir Geoffrey's actions as Chancellor have had little to do with the increase in unemployment up to the end of the summer of 1980, any more than the relatively low levels of unemployment experienced during 1974 had anything to do with the advent of Mr. Healey.

Further, in this matter of unemployment, for an economic assessment we must take into account its cyclical character. The western developed nations are all subject to a 9-year trade cycle. Since the war, this cycle has taken on the form of a 'W' – a major peak followed by a recession, then a minor recovery followed by another recession, before recovering again to a major peak.

The last major peak was in 1973. By May 1979 and throughout 1980 the developed nations were sliding into a recession, which is now tending to bottom out. If past experience is anything to go by, and in this matter there is little else but past experience to go on, from past experience we may expect a recovery to become evident before the end of this year, 1981 – and for the upswing to continue throughout 1982. The unemployment cycle tends to lag some six months behind the phases of this trade and output cycle.

Thus economics leads to the conclusion that when Sir Geoffrey accepted office in May 1979 there was little he could do to stop unemployment in this country touching the two million marker during 1980. From an economic view we observe that by the time

of the last General Election in 1979, such a figure had become the inevitable result of our past national policies, reinforced by certain international forces then already in motion.

But Sir Geoffrey could have taken corrective action in his first Budget, and the requested papers on how this might be achieved were delivered[1] on the day this administration took office. He could have taken corrective action in his first budget that would have minimised the recession, and by now we could be looking forward to steady improvements during this year and beyond. Moreover, if this corrective action had been taken in June 1979, it would have assisted the attainment of those publicly declared monetary objectives believed to be essential to the government's medium term strategy.

Turning to counter-inflation policy – the government's first priority – the monetarists' view is, in general, that a government must first establish control over the quantity of money, and then exercise this control to effect a restriction of the money supply.

This view is based directly on the restated quantity theory of money, although there are differences of opinion amongst quantity theorists on issues of practical policy – whether the quantity of money should be controlled through a cash base, or through an eligible reserve asset base, and so on.

There are differences of opinion also as to the speed at which a government should proceed. Professor Hayek favours the 'at a stroke' policy. He asserts that an electorate prefers a 20 percent unemployment rate for a few months to a 10 percent rate for a number of years. Professor Friedman, on the other hand, advocates a more gradual approach to a quasi-automatic monetary policy that would offer, he claims, the opportunity of much growth with little inflation.

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1 Papers offering economic advice were submitted to government by Ronald Burgess at the time of the General Election of May 1979, and received some support from Sir Keith Joseph, but the appointment of Sir Geoffrey Howe as Chancellor of the Exchequer resulted in a very different choice of economic policies than those that had been expected.

But these differences amongst academics about practicalities are in the realms of theory in relation to a review of Sir Geoffrey's first eighteen months as Chancellor of the Exchequer. Although throughout his time as Chancellor the government of today has been publicly committed to monetarist policies, he has failed utterly to control the quantity of money and thus meet the first requirement of the quantity theory.

According to the late Professor Harry Johnson, who was a colleague of Professor Friedman at the University of Chicago, the quantity theory predicts the rate of inflation to be the difference between the rate of increase in the money supply and the rate of growth of real output. Therefore, on the basis of the published evidence, the theory predicts for this country a 15 to 20 percent inflation rate during the next year or two.

Yet, since last summer, the rate of inflation has been falling and over the past six months, calculated on an annualised basis, the rate has been within single figures.

When the predictions from the quantity theory are compared with what is actually happening to prices then, if one accepts the quantity theory, it has to be concluded that the reduction in the inflation rate, last year and during this coming year, must be the result of the slump and the strength of the petro-pound rather than the outcome of an effective monetary policy. Sir Geoffrey may have tried to implement monetarist policies, he may have tried to restrict the quantity of money, but so far he has failed. Indeed he cannot be said to have even begun to follow the medium term strategy of squeezing out inflation by restricting the money supply.

As Sir Keith Joseph has admitted, perhaps too honestly for a Cabinet Minister, the government lost their first year. But if we go along with Sir Keith, and to do so is no more than accepting the published evidence, what went wrong? Why did the government lose their first year?

Some members of the government would stress their failure to reduce the borrowing requirement. But those politicians who give

top priority to reducing the borrowing requirement at this time cannot claim the unqualified support of the quantity theorists, for Professor Friedman asserts that fiscal policy does not matter for inflation providing any budget deficit is covered by what he calls true borrowing – that is, borrowing that removes purchasing power from the rest of the economy, and does not tend automatically to increase the quantity of money.

Although Professor Friedman's assertion is a misleading overstatement of the quantity theory case, nonetheless, the theory does imply that in the medium term the method by which a government borrows is more important than the size of the deficit. The only borrowing limit applicable to the medium term is that the deficit must not exceed a sum that can be covered by 'true borrowing'.

However, the medium term in this context is some four years, so there is ample scope for political judgement as to timing. No matter how well founded a policy may be in theory, it will be a bad policy if implemented at the wrong time. When this government assumed office the world economies were sliding into a recession; a modern government cannot cut its borrowing requirement on the downswing of the trade cycle, and there is nothing in the restated quantity theory of money that implies it must make the attempt.

It is true that a substantial borrowing requirement does make life very difficult for a Chancellor who is committed to squeezing inflation out of the system by restricting the quantity of money. As he must eschew 'printing money', he has to turn to the more expensive methods of covering a deficit. Should he attempt to raise substantial funds from the market at the same time as he restricts the quantity of money, then he is in danger of squeezing out, not inflation, but productive investment. He will be appropriating for government use the funds needed for production.

Yet these difficulties are compounded further when during the downswing of a trade cycle a Chancellor attempts to reduce his borrowing by either cutting public spending, or by raising taxes, or by some combination of those two. If he attempts to cut public

spending, the public view of this Cabinet to date, then he reduces the aggregate demand at a time when it is already falling. The recession becomes a slump. If he attempts to raise taxes, the view of Mr. Healey in 1974, of Mr. Enoch Powell in 1980, and it is forecast this Cabinet's view in 1981, if the Chancellor attempts to raise taxation then he increases costs, squeezes profits, and causes more bankruptcies. The recession becomes a slump.

When the economies of the world are sliding into a recession any deliberate attempt to cut the general government borrowing requirement is sufficient to precipitate a national slump, and the greater the resulting contraction of activity the larger will be the eventual borrowing requirement.

When people are thrown out of jobs not only do they cease to contribute towards government expenses but they themselves become an additional government expense. Unemployment is a very expensive social disease for a Chancellor.

During their first eighteen months the government have failed to exercise good judgement in timing the implementation of those policies they considered necessary for achieving their medium term strategy. Had Sir Geoffrey at the outset given top priority, not to cutting the borrowing requirement, but to minimising the effects of a world recession on the British economy then, during this year, the amount that he needed to borrow would have tended to fall automatically, and he could have speeded up the process with advantage to everybody.

To sustain a prosperous economy without inflation it is necessary for government, taking one year with another, to pursue an overall balanced budget policy; reducing the deficit is only a beginning. But the process can begin only at the right time, and adherence to monetarism does not preclude the exercise of political judgement as to timing.

That the government lost their first year, and more, is due not so much to their monetarism as to their lack of understanding of the theory from which they claim to derive their policies.

From listening to government ministers one might well believe that they are committed to a money supply theory. In fact the restated quantity theory of money is not concerned directly with the money supply – it is a theory about the demand for money. Put very simply, the theory's central proposition implies that the demand for money and the general price level will tend to rise and fall together. If prices rise for any reason then the demand for money will increase. If prices fall then the demand for money will decrease.

The restated quantity theory states that for any economy there is a stable demand function for real balances. Academics may dispute the details within the brackets but in general the proposition accords with the facts of experience. If we have to pay higher prices, then we need more money in order to do so.

From the proposition that there is a stable demand function for real balances, quantity theorists argue that an increase in the quantity of money will cause the supply of money to exceed the demand for money. This excess money supply will tend to reduce interest rates and thus lead to an expansion in the demand for investment goods. The excess supply of money will be reflected also in an increase in nominal wealth and thus lead to an expansion in the demand for consumption goods. The expansion of demand in the goods markets will spill over and expand demand in the labour market. As aggregate demand expands, so the argument goes, wages and prices rise, and as wages and prices rise the demand for money increases until the equilibrium between money supply and demand is restored at some higher general price level, or when the rate of inflation becomes fully anticipated.

There may be some weak points in the chain of reasoning but in general it is a logical argument deduced more or less directly from the restated quantity theory of money which, as Professor Harry Johnson has stated, is essentially a generalisation of Keynes's theory of liquidity preference. Indeed up to this point the reasoning of contemporary quantity theorists is not substantially different

from Keynes; in the 1930s, Keynes concluded that in conditions of less than full employment any increase in aggregate monetary demand would cause some expansion of output and employment and some increase in prices.

However, what we need to note well is that the contemporary monetarist argument is not a general case but a special case of monetary theory. The argument, its conclusions, and its policy implications, can be applied to the real world only in the case where the initial impulse is a monetary impulse, that is where the sole causative factor of an inflation is an increase in the supply of money.

In 1956 Professor Friedman failed to observe that his chain of reasoning applied only to a special case. He assumed the line of argument I have outlined to be the general case and from this he concluded that "inflation is always and everywhere a monetary phenomenon" – that always and everywhere, it is prior increases in the money supply that lead to rising prices and that for inflation only monetary policy matters. Given Professor Friedman's assumption that an inflation is always started by an excess money supply then it follows of necessity that once an inflation has started it can be halted only by restricting the money supply.

There is an element of truth in Professor Friedman's conclusions. The restated quantity theory of money does imply that the proximate cause of inflation is, always and everywhere, an excessive money supply. It predicts that if the rate of increase in the money supply does not persistently exceed the rate of growth of real output then there can be no inflation, although a stable general price level – Keynes's stable equilibrium – may still be associated with a low level of economic activity or even an intensive slump.

But, whilst it can be deduced from the restated quantity theory of money that the proximate cause of inflation is, always and everywhere, an excessive money supply, it cannot be deduced from that theory that the primary cause of inflation is of necessity

an excessive money supply. The theory admits of other possible primary causes, and so, one has to distinguish between Professor Friedman's conclusions, derived from his own assumptions, and conclusions that are derived from the theory itself. Contemporary monetarists do not always make this necessary distinction.

We know, as a matter of recent experience, that when Sir Geoffrey nearly doubled the rate of VAT in 1979 there followed a sharp increase in prices – prices rose as a result of a fiscal impulse, not a monetary impulse. According to the conventional wisdom of demand management such a fiscal impulse causes only a once and for all rise in prices and of itself may be deflationary since, as it is said, it will mop up excess demand. This piece of economic nonsense is accepted by Sir Geoffrey as a basis for policy but it is drawn from the 'real income and expenditure' approach, not from monetary theory.

In this country we are now in the fifth decade of persistently rising prices. We know that as prices rise, for whatever reason, our real incomes are eroded. We know also, as a matter of repeated individual experience, that as real incomes are eroded then not only trade unionists but all income receivers demand higher money incomes. Landlords up their rents, shareholders demand more in dividends, those in retirement feel entitled to higher pensions, students want bigger grants, and everybody in employment asks for extra money in their pay packet. Further, the operation of fiscal drag results in a more than proportional rise in gross money incomes.

A fiscal impulse does not have a once and for all effect on prices; it sets off a chain reaction. It motivates a complex tax shifting process that tends to be self-generating. In another context Professor Friedman asserts that you cannot fool all the people all the time. I agree. But if one accepts that people are not subject to money illusion then one must accept that they will retaliate against tax inflated prices by demanding higher money incomes and the increased cost of meeting these demands will raise prices yet

again, leading to further demands, and so on, and so on. As prices rise, predicts the quantity theory, the demand for money will increase also. Thus we must conclude that a fiscal impulse as well as a monetary impulse can cause a continuing rise in prices and a corresponding continuing increase in the demand for money.

Once it is noted that the restated quantity theory of money admits to fiscal policy as well as monetary policy being possible primary causes of rising prices, then the theory becomes useful for evaluating alternative monetary policies.

When government inflates prices by fiscal policy they can meet the tax inflated demand for money by an inflationary supply of money. If they choose this monetary policy then the primary fiscal impulse will be dissipated in rising prices with little or no effect on output and employment. By an inflationary fiscal policy allied to an inflationary monetary policy the government create persistent tax inflation – that is, persistently rising prices motivated by excessive taxation.

Alternatively, the government can refuse to meet the tax inflated demand for money with an inflationary supply of money and if they choose this policy then, the quantity theory predicts, the primary fiscal impulse will precipitate a slump. By an inflationary fiscal policy allied to a restrictive monetary policy the government create a condition of suppressed tax inflation – the inflation is suppressed by the slump – by the fear of unemployment.

Put another way, the quantity theory predicts that if government inflate the demand for money by their fiscal policy then their monetary policy will become an instrument for determining the trade-off between the rate of inflation, and the rate at which output and employment contracts.

The restated quantity theory of money leads to the conclusion that in this country we suffer from persistent tax inflation, not monetary inflation. A restrictive monetary policy can only suppress tax inflation and this suppression is achieved by precipitating a slump. Once the slump is over the tax inflation will re-appear.

Let us now consider the last eighteen months in the light of the quantity theory itself, rather than in the shadow of the various assumptions and assertions that have been added to that theory.

Starting with the June 1979 budget, we come immediately to another piece of economic nonsense; again not drawn from monetary theory, or in this instance any other theory, but based on a misleading use of statistics by the Central Statistical Office.

Every year the Central Statistical Office (C.S.O.) publishes an international league table which purports to compare the tax burden of a number of leading industrialised nations. This month the table for 1979 was published and, on the basis of expressing total tax revenue as a percentage of the Gross Domestic Product at market prices, the U.K. comes tenth out of eighteen nations. From this exercise the C.S.O. concludes that all E.E.C. countries, with the exceptions of Ireland and Italy, are more heavily taxed than the U.K. The Times published the report on 8th January under the headline 'Confounding myth of heavily taxed Britain'.

Admittedly the most recent calculations are an improvement on earlier attempts but they remain misleading nonsense – the method used is not a valid basis for comparing international tax burdens. The amount of tax as a percentage of its GDP at market prices that any country can bear without deleterious side-effects is relative to that country's economic potential – the higher the potential, the more able it is to pay taxes.

You will appreciate that a store in Kensington High Street, by reason of its geographical position, is able to pay more in taxation and still remain highly competitive than, say, a village general store. As within a country so it is between one country and another.

The Treaty of Rome, by creating a vast western European customs union, changed the relative economic potentials significantly. Its effect may be considered as having moved West Germany and the Benelux countries onto prime sites along Kensington High Street, and at the same time moving British manufacturers way down a side street.

If Britain is to prosper then the government at Westminster and the Commission in Brussels must recognise the situation that exists. This country's economic potentials now approximate to those of Italy; higher than Ireland, but lower than other E.E.C. nations. We cannot afford to have such a large slice of our national cake appropriated by taxation. We are over-burdened with taxation, and in particular home producers are over-burdened with taxation.

The evidence was first published in 1969, following research that was carried out at Oxford under the direction of Colin Clark. I re-evaluated that evidence in relation to fiscal policy in E.S.A. Paper No. 3 published in January 1973, but none of this has yet penetrated the bureaucracies responsible for public finance – they continue to ignore the evidence and accept the nonsense.

From misleading official statistics given the official accolade of the C.S.O. it is concluded that we are not over-taxed, but that it is our heavily progressive present system of income tax that acts as a disincentive to work and enterprise. This has become part of our politicians' basic mythology.

In June 1979 Sir Geoffrey acted upon this nonsense – he did not attempt to cut taxes but switched part of the burden from direct to indirect methods. This, he believed, would provide the incentive for carrying through the medium term strategy. Asinine? Possibly, yet in the House of Commons he was surrounded by over 600 Members of his own kind, and they were supported outside by the majority of so-called informed economic opinion.

Sir Geoffrey's first act was to raise the basic rate of VAT from 8 percent to 15 percent. The inevitable result was a sharp rise in prices. Given such a result the restated quantity theory predicts an increase in the demand for money that will make it more difficult to control the quantity of money. Further, if the money supply is not increased to meet the tax inflated demand for money, then the theory predicts a trade-off between rising prices and a contraction of output and employment – the degree of trade-off being determined by the elasticity of the money supply.

So far the sequence of events has been fully consistent with the predictions from theory. By his very first act as Chancellor, Sir Geoffrey dealt a severe blow to his medium term strategy and to the British economy – not by pursuing monetarist policies, but by acting on a myth cultivated by misleading statistics published by the Central Statistical Office.

Oh for Sir Alec, and his matchsticks![2]

The corresponding part of this first budget was the announcement of a cut in income tax to take effect later in that year. A cut in income tax does not immediately affect an employer's labour costs; what it does is to leave more money in the pay packet. The supposed incentive of the two measures meant only that people were left with a little more money in their pockets to pay the tax-inflated prices. It was just another twist to the screw.

The other important tax measures have been the increase in social security taxes last April, and the announcement of further increases in the Autumn Statement of last November.

On the employees' side, an increase in so-called National Insurance cuts take-home pay and claws back any benefit from the earlier cut in income tax. Overall, the tax-imposed cut in earned incomes means less money to pay the tax-inflated prices and this must intensify the depression. Worse, an increase in employees' contributions falls heaviest on the lower paid, those who gained least, or nothing at all, from the cut in income tax.

On the employers' side, the employer's contributions and the National Insurance surcharge increase labour costs directly. In times of economic depression when profit margins are often non-existent firms have no option but to react to additional tax inflation of their labour costs, by raising prices, by cutting back on output and employment, or both – once again the trade-off, once again a prediction from the restated quantity theory is confirmed.

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2 A reference to Sir Alec Douglas-Home, Prime Minister from October 1963 to October 1964. In an interview with The Observer newspaper in 1962, he said that, when asked the question of whether he would ever become Prime Minister, he had once replied "No, because I do my sums with matchsticks."

Another policy instrument that Sir Geoffrey has used is the imposition of high nominal rates of interest. Now there are monetary theorists who argue that high interest rates tend to reduce the demand for money and thus make it easier for the government to restrict the supply of money. However, the restated quantity theory implies that the interest elasticity of the demand for money is small, and the majority of quantity theorists argue that a government can control either the quantity of money, or interest rates, but not both at the same time. They argue in favour of government controlling the quantity of money and of leaving interest rates to be determined by the open market. So although the fixing of interest rates has been an important part of Sir Geoffrey's policy there are many quantity theorists who would deny that such actions are an essential part of monetarism. Rather, they maintain that fixing interest rates is contrary to monetarist policy.

What then are we now to conclude about monetarism and Sir Geoffrey Howe from the evidence of his first eighteen months as Chancellor of the Exchequer?

First it has to be admitted that Professor Milton Friedman, and many of his followers, dangerously overstate the monetarist case in public. It would appear that the government have been misled by these overstatements from presumed authoritative sources. The assertion that fiscal policy does not matter for inflation is derived not from the theory, but from an assumption made by Professor Friedman. Relax the Professor's assumption, and the theory carries very different policy implications. Fiscal policy does matter.

Second, whilst it may be permissible to argue that Sir Geoffrey is a disaster, or a saviour, depending upon one's political stance, it is not permissible to argue that his success or failure is a result of his monetarist policies, in the sense of being the certain result of implementing policies derived from the restated quantity theory of money. He may have intended to implement monetarist policies, but so far he has failed to do so. This government may be publicly committed to monetarism but if they are to be judged by the

Chancellor's actions then they are not monetarists. Sir Geoffrey is far less of a monetarist in practice than was his predecessor, Mr. Healey.

Third, whilst agreeing with Professor Ball that eighteen months is too short a period to pass judgement on the government's medium term strategy, we can assess the performance of the restated quantity theory of money. Shed of its added obscurities, the theory stands up well – so far, it has shown itself capable of predicting with reasonable accuracy the inevitable results of ill-timed and misconceived policies.

Yet, criticism from a vantage point well removed from the activity and with the advantage of hindsight is all too easy. Such criticism has its place in political economy but it is not the end purpose. Macroeconomic science is sterile unless it gives to any government practical advice, appropriate to time and circumstance, on matters economic.

The advice that Sir Geoffrey is receiving now falls into three broad categories. There are those who are advising Sir Geoffrey to expand his horizons and not place too much reliance on quantity theorists and monetary policy. I trust I have said enough tonight to demonstrate that most of Sir Geoffrey's difficulties and ours arise from his ignoring the implications of quantity theory and from his pursuing policies based on other theories and the widely accepted economic mythologies.

Others, like Professor Ball, advise pressing on regardless of immediate difficulties. They argue that some short-run costs are inevitable and that eighteen months is too short a time to assess the medium term strategy. But how can the government press on with something they have not even started? A prerequisite of their medium term strategy is the control over the quantity of money, not the suppression of tax inflation by turning a recession into a slump.

Yet others advise a U-turn, either because they consider the short-run costs are proving too high, or because they reject outright

the basis of the medium term strategy. As an alternative this group advise an extension of government controls: import controls, dividend controls, wage controls, price controls, trade union controls, and so on.

Tonight, Mr. Aubrey Jones, boss of the old Prices and Incomes Board, is attempting to influence a Liberal Party economics group. What do such men of yesteryear offer? Like the new Cambridge group, these middle-ground men also are proposing a shift towards a bureaucratic state with a fully controlled economy. Their proposals have been tried and have failed. The electorate have rejected them not once but many times since the war.

Of what assistance is this conflicting and mostly politically unacceptable advice?

Sir Geoffrey, for better or worse, is a member of a government publicly committed to a definite medium term strategy. His Prime Minister, the First Lord of the Treasury, frequently re-affirms her adherence to that strategy, come what may in the short run.

What can the Chancellor do now and remain a member of the present Cabinet? The British economy is failing, the British people are suffering. Although we alone amongst the E.E.C. countries are self-sufficient in energy supplies, the present world recession appears to be affecting Britain more than the other industrialised nations. Are our choices limited to either accepting rising unemployment in the hope that it will reduce the rate of inflation, or making a U-turn, accepting state bureaucracy and accelerating inflation, in the hope of reducing unemployment?

Sir Geoffrey may be likened to a man who one cold morning is given the keys to a car he has for long coveted. In his exuberance he does not notice the car is parked on a hill, he jumps in, and takes off the brake before starting the engine. The car careers backwards downhill at an accelerating rate. In the circumstances, however foreseeable they may have been, to carry on, or to do a U-turn, is likely to prove equally disastrous. The car will be a write-off whether it hits the wall at the bottom boot first, or bonnet first.

The drill in such an emergency is to stop, and then start the engine. When the engine is warmed up, the driver can simultaneously take off the brake and let in the clutch. With this the car may be driven speedily and safely in the desired direction. A British driver has the advantage of a full North Sea tank.

Translated into terms of economic policy, Sir Geoffrey must stop attempting to cut the borrowing requirement, he must stop attempting to cut public spending, he must stop attempting to raise tax revenues. He cannot achieve these objectives as the economy slides into an ever deeper slump, and his adherence to monetarism does not require him to attempt the impossible.

Having stopped attempting the impossible he can make a start. He can begin by relieving producers in this country of their crippling employment tax burdens so that efficient firms can expand employment and sell their production at a profit in the competitive markets of the world. He can begin by reducing the tax inflated demand for money. With the economy running again, he will find, as it warms up, that government do not need to spend as much. He will find his tax yields recovering. He will find the general government borrowing requirement tending to fall automatically.

With all this happening, he will then be able to control the quantity of money, and proceed towards a prosperous economy with a balanced budget and a zero rate of inflation. As I understand it, that is the purpose of the medium term strategy.