THE ECONOMIC ADVISER'S ROLE: Scope and Limitations

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Preface

Professor Alan Walters, a distinguished and original economist, was summoned from a Chair of renown at Johns Hopkins, Baltimore, USA, to become the Prime Minister's special economic adviser at the beginning of 1981. Many Prime Ministers in the past have had similar advisers or, at least, persons to whom they regularly or irregularly (as the case might be) turned for economic advice. Professor Walters now has an office in 10 Downing Street and, at the time of writing, has been, for him, remarkably silent. The occasion of his lecture at the Conservative Party Conference at Blackpool is the first time that he has spoken publicly of what has been happening to him since January 1981. Those who listen to him, or read him, will thus here gain a little insight into the character and the nature of the mind of this remarkable professor. We are for a short time, as it were, in the shoes of the Prime Minister to whom he talks more regularly than he does to us. It is a privilege to have Professor Walters at Blackpool; and it is a great pleasure that what he is saying there will be available through this publication to a wider audience.

Hugh Thomas

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THE ROLE OF AN ECONOMIC ADVISER

There is not much mystery to the job description for an economic adviser. He is expected to give advice on economic matters. But like most job descriptions it conceals more than it reveals. Unlike the Emperor, the economist does have clothes of sorts — although views differ as to whether the garb is that of a dunce, a fool or an undertaker.

But we can all agree that an economic adviser must be in a somewhat different position from an adviser on, say, public relations. Economics is often said to be a scientific discipline, whatever that may mean, whereas I do not think anyone would claim there is a science of public relations. In economics one is expected to understand general principles which are applicable in a very wide variety of circumstances. If you ask an economist to explain how he would predict the exchange rate between fish and fowl in an African village, he would use more or less the same analytical discipline as he uses for explaining the exchange rates between financial instruments in the complicated markets of the West. The basic analytical laws are the same. Whereas no-one could pretend that a public relations expert would have the same role in the African jungle as in the boardrooms of the City.

The Development of Economics

Yet it is as easy, perhaps even easier, to purvey nonsense under the guise of economics as it is to produce manifest absurdities in public relations. One of the most perceptive remarks Joan Robinson ever made was* "The purpose of studying economics is not to acquire a set of ready-made answers to economic questions, but to learn how to avoid being deceived by economists". Since she wrote those words the tricks of the economic trade have multiplied apace and it is even more perilous to neglect one's defences against deception.

The number of economists, and in particular the number of *academic* and *government* economists, has grown very rapidly since the 1960s. This very rapid expansion of economics since the Second World War was *not* a consequence of the increase in the growth of knowledge leading to an enormous quantum jump in the number of people and money attracted to it.**

*Joan Robinson, Collected Economic Papers 1960

**The issues discussed in this paragraph have been examined at length in P.T. Bauer and A.A. Walters "The State of Economics" *Journal of Law and Economics* Vol. 18 No. 1 April 1975. The number of teaching posts in British universities has expanded from 166 in 1947 to 1,031 in 1974. Economists in government expanded from 10 in 1945 to 352 in 1975. See A.E. Booth and A.W. Coats "The Market for Economists in Britain 1945–75 a Preliminary Survey", *Economic Journal* Vol. 88 Sept. 1978 p.436–454.

To a very large extent the expansion resulted from the belief that economists could help significantly in solving social and political problems and secondly that their capacity to do so depended on the numbers and amount of money available. But the increase in the number of economists didn't help solve problems. Indeed economists tend to be in the business of creating problems rather than solving them.*

Another feature of the development of economics since World War II has been its acquisition of all the apparatus of science. Increasingly mathematics is used to describe economic processes. There has been a burgeoning expansion of econometrics where economic theories are tested against real data. Economics has become technically much more efficient and, inevitably, more esoteric.

But the formidable mathematical or statistical techniques create a barrier which inhibits searching examination of theories of modern economics. The critical evaluation of economic propositions has been impeded by another phenomenon — the increasing specialisation of economists into particular fields of subjects.** While such specialisation cannot be avoided and indeed is in some respects to be welcomed, it does pose grave problems. Although there are undoubtedly impressive strides being made in conquering new territory on the frontier of our subject, one has difficulties in interpreting messages that come back from these frontiers. How seriously should we take the reports of success?***

There is a considerable deterrent to a scholar attempting to enter a specialised field in order to criticise the consensus. One must acquire a very considerable body of knowledge, often with an esoteric language all of its own, and one must have a considerable amount of money in order to run the various computer models and prepare the data. In my experience the discouragement is very real. For example, I undertook to write a critique of the various models of the United Kingdom — especially in their efficacy in predicting the inflation of 1974–6. While I managed to make some substantive points, I found that in order to be suitably *au fait* with the models I would

*Witness the "recycling problem" of the first oil price increase of 1974. Fortunately the recycling problem was solved by practical bankers, persuging their own self-interest, long before the economic profession could get around to tackling it through the institutions of the United Nations etc. Other "problems" such as the "vicious circle of poverty" and the "widening gap" or the "two gap problem" need not detain us here. See Bauer and Walters *op cit*. Furthermore, in economics there is a peculiar confusion of increasing knowledge on the one hand, and the promotion of particular policies on the other. While in principle the two are quite distinct, in practice they are often confused and frequently merged entirely.

**For an amusing account see Axel Leijonhufvud "Life among the Econ" *Western Economics Journal* Sept. 1973

***For the views of a distinguished Nobel Laureate on the validity of such reports see Wassily Leontief "Theoretical Assumptions and Non-Observed Facts" *American Economic Review* March 1971

have to invest many months of my time and considerable money in experimenting with the model. I was properly put off.* Thus there is a distinct danger of a particular field of economics being ploughed only by the cognoscenti. Since they have a vested interest in retaining the utility of their techniques, which they have acquired only after a long investment of time and effort, there will be also a risk of hostility to outsiders who question their results.

The free competition of ideas is the best protection against such intellectual corporatism. Free enterprise is as essential in ideas as it is in the production of products. Still in much of Britain there is an open society where outsiders can get a hearing and sometimes win the battle of ideas. One of the most remarkable examples in recent years has been the rise of the view that money matters — sometimes called monetarism.

Monetarism

For many years it was fashionable in economics to regard monetary events as a minor institutional concern. The structure of credit and interest rates were required to accommodate to the really important decisions handed down from the 'commanding heights' of the economy and from the budget. The quantity of money was thought to be of no great consequence. Indeed when I returned from the United States in 1960 I discovered that there were no official statistics on the quantity of money in the United Kingdom. This was a reasonable view on the part of the authorities: if money didn't matter very much then why bother to collect statistics on it? And when a team of us in Birmingham started collecting and analysing data on the UK money supply from 1960 onwards, we were regarded as cranks. Indeed my attempts to get a small research grant were turned down by all the institutions, including the Bank of England, to which I applied. However although we weren't actually supported in our endeavours (except by the Institute for Economic Affairs),** at least we were not stopped or banished to a psychiatric hospital!

Having identified monetarists as cranks they were automatically assumed to be more or less harmless. But that did not mean that monetarists were welcome in the great universities of the United Kingdom. Naturally, academic economists appoint and promote economists who have ideas which are broadly consistent with their own. Understandably, they do not really like doctrinal conflict. Most economists believed, and still believe, that monetarism is not right. Search in the two great universities of Oxford and Cambridge and see if you can identify anyone who will admit to being a monetarist. Of course there *were* one or two in Cambridge, for example the late Professor Harry Johnson, and you will still find one or two in the University of

*See my article in Michael Intrilligator (Ed) *Frontiers of Econometrics* North Holland 1976.

**The encouragement of Mr. Ralph Harris (now Lord Harris of High Cross) and Arthur Seldon was a godsend. Ultimately some of the results were summarised in my paper *Money in Boom and Slump* IEA, 1968 1st Edition, 1970 3rd Edition.

London. But generally monetarists are now collected in Liverpool, the City University and in the London Business School. The new universities which expanded so rapidly in the 1960s and early 1970s are to a large extent staffed by anti-monetarists and quite often by economists who espouse the collectivist or corporatist ideas, so popular when they were impressionable students. Yet, in spite of the academic opposition, monetarism captured the attention and support of a very wide variety of opinion.

If academics did not change their views, you may well ask what were the crucial arguments or events that swayed opnion? Perhaps the most impressive was the fact that in the economies of the world which have been clearly most successful, Germany, Japan and Switzerland, the tenets of monetarism, rather than the propositions of post-Keynesian economists, had been the central guideposts for policy.* Thus in Germany the main objective of policy was to keep a steady control of the quantity of money and to pursue brroadly balanced budgets. The Japanese had hardly heard of Keynes and had built their monetary system on the prudential principles of a Mid-Western banker, Mr Dodge. The Swiss have always pursued frugal monetary and fiscal policies – and have the highest income per head in Europe. Similarly, in America from the end of the Korean war to the mid-1960s, when there was fairly steady growth and remarkably little inflation, the Truman and Eisenhower administrations pursued a policy of slow monetary growth combined with balanced budgets. Whereas, of course, Britain was, during the heyday of post-Keynesian economies, nearly the slowest grower and suffered continuous and increasingly severe bouts of inflation. Britain was indeed the sick man of Europe.

I believe, therefore, it was a combination of the dismal performance of the UK compared with our trading partners, the dramatic experience of the United States during the Johnson inflation from 1965 and the general understanding that something *was* wrong with our system of management of the economy, that gave rise to the widespread belief that the tenets of monetarism were at least approximately correct. But this was the view of the City and Westminster, and was not held in Groves Academie. The basic intellectual paraphernalia of academic economists is clearly opposed to monetarism. And we know that monetarism is often, but not always, associated with a strong belief in what the Germans would call a social market economy. This means broadly a reliance on free enterprise, private property and on all other accoutrements of a liberal order. In such a liberal order, compared with the mixture of corporatism and socialism that is still so popular in economic departments, there is a much smaller demand for economists.**

*I prefer to use the term "post-Keynesian" since it is very unlikely that Keynes would have approved of the analyses and policies which have usurped the description of "Keynesian".

**(I am told, for example, that in Soviet Russia there are more economists per thousand population than in any other country. And, of course, with their system, they need them.

Advising as an Odd Man In

I thought it necessary to describe at some length the state of economics because it does define the context in which an economic adviser must work. It is an environment where many of the clerisy imbibed post-Keynesian ideas of economic management. These are more or less the antithesis of the ideas of monetarism and a social market economy which underlie the policies of the present government.

I have the general framework of a monetarist. The words monetarism and monetarist have been debased in the press and political discussion so that they are now terms of unthinking abuse. Yet the monetarist, at least as I understand it, is merely an economist who believes that the money supply is rather important and cannot be dismissed with contempt. Being a monetarist does not imply one follows some simple dogma. Indeed, among virtually all the economists I know who are classified as monetarists, none of them could conceivably be said to be dogmatic. For example, no monetarist would say that the quantity of money, defined in a particular way, should increase week in, week out, or month in, month out at a certain predetermined rate. Yet this is how they are described by their opponents.*

Monetary policy is a much more subtle matter than this. As Friedman himself has pointed out, in the short run monetary policy, in its day-to-day operations, is dominated by liquidity considerations. In the medium term such as the period of one year to about two years, we are mainly concerned with preventing monetary variation having effects on the real economy, that is to say either over-stimulating or over-depressing the real economy. In the longer term, say over three years, the main concern is to control the level of inflation.

Monetary policy should be used only for attacking monetary problems – such as to contain inflation and to prevent liquidity crises. It cannot, or strictly should not, be used to ensure 'full employment', maximum growth, equitable shares etc. These are problems of the real economy that must be dealt with by appropriate *real* policies. Yet a stable monetary policy can be of considerable help in providing a stable environment for real reforms.**

This is a complicated, subtle scenario and it is a travesty to describe it as simply sitting tight day-in, day-out on the money supply. These are complex requirements of policy and one cannot expect anyone, alas including many professional economists, to have an adequate knowledge of the subleties involved. Each interest group will be pressing for its own solution – businessmen for lower interest rates, bankers for assured liquidity, and so on. The Minister needs protection.

The adviser must provide the Minister with a critical account of various

*Recent examples are the superficial and specious comments by David Blake in *The Times.*

**See Sir Keith Joseph "Monetarism is not enough" CPS, 1977 ideas and propositions which are fed to him or her. In its most elementary form it is, of course, identifying nonsense and economic error in the propositions which are put forward. His job is to expose the quack cures. In my experience the job is made difficult by the fact that the economic questions are — inevitably in a democracy — inextricably entangled with political and social issues.

Probably the main unsolved problem of providing advice is to what extent one should leave the economic last and take into account the various other disciplines and limitations that impinge on policy. I think I can go *some* way towards answering this. I believe that it is incumbent on an economic adviser always to make sure that the policy advice he gives is *administratively* feasible. Policy prescriptions must always be *practical*. Similarly, the economic adviser must take a view about the sociological or political possibilities involved. It is simply a waste of time if he pursues policies and provides detailed advice on matters which cannot be said to have any political chance of acceptance.

However I do not wish to suggest the adviser should restrict his policies to what is 'politically acceptable'. One must be very careful not too hastily to embrace the judgment that some policy is politically impossible. The allegation of political impossibility is a very convenient phrase which it is hoped will preempt all further discussion. But during my career as a professional economist I have seen many, many phenomena which were universally regarded as politically impossible become not merely possible, but indeed the conventional wisdom! There was the conventional wisdom that one could reduce unemployment by inflation (reflation, expansion etc) — yet we know that inflation and unemployment have increased together throughout all Western economies. It was also said that it was impossible to float the pound: "it would fall through the floor". Actually the pound never fell through the floor at all, it has reached new heights. And so on.

It is important for an adviser always to think the unthinkable. As a corollary he must expect to get much of his advice turned down on political grounds. His main task, however, is to make sure that the economic arguments, the unsuspected consequences, the economic costs and benefits, are adequately appreciated. But he should also devise policies that are politically attractive. To give you an illustration from history; had I been advising the Federal Government of the United States in 1859/1860 then I should have strongly argued that if they wished to abolish slavery then they should certainly pay compensation. Such advice is fully within the duties of an adviser.

Now I know there is no neat, logical line which one can define as the limits of the economic advice. There must always be doubt how far one should go in trimming policy. There are no professional codes of ethics: one must rely on judgment.

Of course there are great temptations. Economics, like most of the other

social sciences, can easily become so politicised in its content as to become virtually useless. It becomes then merely the meretricious trappings of some ideological crusade. This politicisation of economics — more accurately described as usurping of economic theory by political prejudice — is I think more significant in some of the departments in British universities than it is in the Civil Service or in business firms. It is a particularly grave problem with economic advisers. For what they must do above all is to provide their Minister with an interpretation of events which faces awkward facts, an appreciation of the worst aspects of policies, and a view of reality as close as one can possibly get to being objective.

This brings me to the central requirement of an economic adviser. He must be quite independent and have sufficient moral courage to pursue his arguments even in the face of the most hostile reception. As many perceptive people have observed, the normal condition of the successful man, whether he be politician, businessman or scholar, is one of optimism. In many historical circumstances the bringer of bad news was, if not actually beheaded, then not very welcome. But the job of an economic adviser is to make sure that the bad news or the alarming elements of any policy are not passed over in the euphoria so necessary to keep momentum. His job is to make sure that the balance is right. Of course, he will be accused of being gloomy, of being negative, of not taking an appropriate positive view. But I suspect that if he is not so accused he has not being doing his proper job.

As a corollary, therefore, the adviser ought to be independent of the Minister. In this sense I mean that the adviser should have no great dependence on the Minister for his livelihood or, indeed, for his future career. It will be good both for the relationship between the Minister and the adviser and for the Minister himself to know that the advice he receives will be untainted by flattery and in no way self-serving. For this reason the tenure of an adviser should be for only a limited period not longer than three or four years. It is important that it not become a career grade.

Of course the ultimate decision of an adviser is whether he can continue to be useful in providing advice on policy, or whether he has become otiose, or whether he can live with a policy which becomes so inconsistent with what he believes to be true. Then what should he do? In my view it is very important that the adviser resign (or be fired).

Such occasions should, in principle, be rather rare. Because of the circumstances under which they are appointed one would not normally see many resignations (or firings) of economic advisers. The adviser and the Minister normally seek one another and should have a mutuality of interest, approach and spirit. If a Minister appoints an adviser whom he does not know well, then he deserves all he gets. And it is, I think, very important on the part of the adviser himself to be absolutely frank about his position on all the major issues and about the way he intends to conduct his end of the affairs.

You will, I am sure, expect me to say something about my experience as economic adviser for these many years. I have been Economic Adviser to the Prime Minister for only a few months and, of course, cannot speak here about that part of my career. However, before that I was economic adviser to the World Bank and to various governments in Latin America, the Far East and other parts of the World.

I have no reason at all to suppose that those who sought me out did not know what they were buying! I have been widely reported in the Press and, I believe, in official documents, as being abrasive and opinionated. And I believe that everyone must know my position on the methodology of economics, monetarism, the importance of the price mechanism and free enterprise and so on. I have never tried to hide my warts under a cosmetic veneer.

Yet it is remarkable to recall that I have had only the most amicable, friendly and productive relationships in my role as adviser. Indeed, one of the most fruitful relationships I have had has been with the World Bank for a period on and off of some sixteen years. Since my first objective was to tell the Bank that they had been doing things exactly wrong as far as their pricing policies were concerned and that they should follow new principles (which I enunciated in a book published some thirteen years ago*), I expected to find that this large, international organisation would be unalterably opposed to such ideas. I thought that the inertia of the international bureaucrats would rapidly suffocate any such notions. I am pleased to record, however, that exactly the contrary was true. There were great difficulties, long arguments and many battles, but the main point was established. The Bank became enormously concerned about efficient pricing mechanisms, and that discussion and debate has prepared the approach to the recent issues on the pricing of energy and related matters.

Having recorded one modest success, however, I ought to record also a dismal failure. I served as an economic consultant to the CPRS in the early days of Mr Heath's government of 1970–74. As economic policy developed in 1971 I was quite convinced there would be a massive inflation and a balance of payments deficit, and all the other sad signs that we had seen so often before when the British government decided to 'go for growth'. I tried to persuade the authorities of the imminence of the dangers they were facing. Indeed, I wrote a paper forecasting that there would be inflation between 10 per cent and 15 per cent in 1974 and that there would be a balance of payments deficit of "at least £1 billion" and that Mr Heath would be driven to a prices and incomes policy. All these warnings were rejected. It was pointed out that the other advisers, and all the modellers at the time, were predicting that, if anything, the inflation rate would go down and there would be no great problem with the balance of payments. I was convinced I was right and my association with CPRS ended. This gave me the opportunity to publish my little article in the May 1972 issue of Sebag's *Gilt Edged Review*. Events, of course, subsequently vindicated my worst fears. And there were many post mortems on these tragic years, the mistakes of which we are still paying for even today.

**The Economics of Road User Charges*, Johns Hopkins, 1968.

The main reasons for the great mistake of 1971–72 are well known and I do not think much more need be said. There is, however, an important lesson for all advisers. The Government's expansion programme from September 1971 onwards was concerned primarily with preventing unemployment going up to the level of (the magic figure then) one million. Of course it was a noble objective to try to prevent the rise in unemployment and keep it well below one million. Whereas my policy of continued restraint may well have produced, at least transitorily, unemployment in excess of one million. The Government wanted to expand public spending and reduce taxes; most governments, indeed, do. And there was an ample number of advisers around who told them that they could do this and nor merely get away with it but also produce many benefits, such as reductions in unemployment and inflation. By the side of these bullish forecasts, I was certainly the odd man prophesying doom.

There was, of course, simply no point in carrying on under those circumstances. In my judgment the government of Mr Heath had changed its policy very dramatically from that which it had proposed in its election Manifesto. This was indeed a U-turn of monumentous importance. And I believe that my judgement at that time has been borne out by subsequent events.

To conclude, I would like to reflect a little on the role of the politically appointed adviser in the United Kingdom and to compare it briefly with the same job in the United States. The most overwhelming and striking contrast between the two is that when a new Government is voted into office in the United States the new Administration is able to make approximately 2500 political appointments. These are not only in the White House but in all the great departments of State. The contrast with the United Kingdom is striking. In the present Government there are only about sixteen political appointees.*

In June 1981 the advisers were

10 Downing Street	– John Hoskyns
	Norman Strauss (part time)
	David Wolfson
	Derek Howe
Chief Whip's Office	– Felicity Yonge
Dept. of Education and Science	– Stuart Sexton
Dept. of Employment	– R. Shepherd
	R. Gilbert
Dept. of Energy	– Michael Portillo
Dept. of the Environment	– Sir Robert Cooke
DHSS	– Professor Roger Dyson
Dept of Industry	– David Young (part time)
Treasury	– Adam Ridley
	Peter Cropper
	George Cardona

In Britain the principle is that the civil servants will work assiduously for the new policies pursued by the incoming Government. But the changing of policies is a difficult business. They need to be articulated and pressed throughout all the various levels of the administration. There is a very natural reluctance on the part of any bureaucracy to change the way they do things. After all they remain while governments come and go. This is a manifestation of what many take to be the admirable stability of the British system of government.

Does our non-politicised Civil Service inhibit change? It is easy to conclude that it does. But I am not sure whether that conclusion is correct. After all the British Civil Service has seemingly successfully not prevented yet survived the most dramatic changes in the UK over the last 35 years. A remarkable achievement. And we shall all be able to observe the performance of a politicised Civil Service in the enormous changes which are predicted in the United States and France. Can they also achieve the nice combination of change of policy *and* stability of form? We shall see.