1966 How to predict the future

Ask a member of the public about London Business School in its early days and there was one thing they knew: its economic forecasts were carried by The Sunday Times. The School had the first working computerised model of the UK economy and while macroeconomics wasn’t necessarily the mainstream of management education, it gave the new School fantastic publicity. It also developed the School’s reputation as an authority on the UK economy and laid the foundations for its leading role in the development of monetarist thinking.

“The School got an enormous amount of attention from it,” says Lord Burns, who’d been brought in as a research assistant by Sir Jim Ball, the School’s founding Professor of Economics and pioneer of econometric models with Nobel Prize-winner Lawrence Klein. “It was extraordinary really. When the first forecast came out it in November 1966 it was on the front page of The Sunday Times and had a two-page spread in the business section.

“We were doing something very different in measuring and modeling the economy and making simulations of policy changes. We changed the way people made forecasts.”

Cutting-edge technology

At the time, economists at the Treasury and the National Institute of Economic and Social Research made forecasts based on a few equations that they used in a manual spreadsheet for consistency. Ball and Burns were estimating their own equations, combining them in a comprehensive model, and using the latest computer technology to solve them. Burns says that after the first forecast the Treasury rang him up to ask how they’d used the model to make the forecasts and what the assumptions were behind it. A couple of years later the Treasury hired Ball and the team’s computer programmer John Eaton to computerise its own system and turn it from a spreadsheet to a consistent model.

The Sunday Times connection continued and the paper carried the School’s forecasts three times a year. In 1967, Ball got a grant from the Social Science Research Council (SSRC) and formed the Economic Forecasting Unit with a team of eight people who also published research.

But it wasn’t easy. These were the early days of computers and Burns would input the code and data on a Flexowriter that punched holes in paper tape. He’d then carry large cylinders of the tapes to Gordon Square, 15 minutes away, where the Unit had hired time on a computer belonging to the University of London and BP that took up two huge rooms. To make any changes they had to splice the tape. As technology advanced, the paper tapes were replaced by boxes of punched cards.

Policy insights

“We had a whole series of equations that had been estimated from historical data,” says Burns. “So relating consumption to disposable income, where disposable income is the sum of wages and salaries and transfer payments less taxes, for example. The model amounted to a set of simultaneous equations that were solved by an iterative process so the results were consistent. You could change the level of government expenditure and see what the impact would be on output, inflation, balance of payments, exports, imports and so on,”

The forecasts compared well with those made by others. The aim was to give an indication of what was going to happen in the economy in the next couple of years so that policy makers could look at it and decide how to adjust policy to keep the economy on course. But it was a time when the forecasts could easily be overtaken by events. In 1967, for example, only their second year of operating, Britain faced a balance of payments crisis and the government devalued the pound.

The Unit’s work got a boost in 1972, when London Business School got its own Hewlett Packard computer – only to be hit by national power cuts. Amid worsening economic conditions and strikes in the UK, Burns remembers the lights would go out and the computer would shut down: “The economy was in serious trouble and the policy debate became very intense from the autumn of that year.”

Troubled times

A lot of people were deeply pessimistic about the economy – not just in the UK but also in the US, which had left the gold standard and experienced student strikes. Amid national post-mortems about why the economy was in such a state, the team started to examine the role monetary expansion had played in the economic problems of the early 1970s, culminating in the UK’s need to borrow from the International Monetary Fund in 1976.

“At the start of the decade the consensus was that inflation was determined by wages so you needed a prices and income policy, and the job of fiscal policy and the exchange rate was to keep demand in the economy at the appropriate level,” says Burns. “But by the end of the 1970s many people had reached the conclusion that prices-income policy hadn’t worked and fiscal policy had to be subordinated to monetary policy to control inflation.”

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Burns soon had a new ally in the shape of Alan Budd, who’d previously been Head of Economic Forecasting at the Treasury before joining the School in 1974. “At the Treasury it had been exciting to be at the heart of economic policy but London Business School was exciting because of the ideas that were being developed there,” remembers Budd, now Sir Alan. “It was a remarkable time and I would give most credit to Terry (Burns). Terry would have the ideas, I would tell him what his ideas were, and we’d write them down.”

**Promoting the new ideas**

In 1976 the Unit was renamed the Centre for Economic Forecasting. It got money from the SSRC for the model-based research and also from companies who were keen to use the forecasts for their own business analysis. Burns and Budd worked on the model to incorporate monetary effects and developed new ideas of how monetary policy could be used in running the economy, which they published in the journal they started in 1977, *Economic Outlook*.

“We worked very hard to get our ideas across,” says Budd. “When a new edition was coming out we’d talk to journalists and explain our ideas to get good coverage. I spent a lot of time on TV and radio. We wanted people to know our ideas.

“These were times when there was great optimism about the ability to forecast and there was a great hope about economic forecasting.”

**At the heart of government**

In 1979 Burns left the School to become Chief Economic Advisor to the Treasury just as Prime Minister Margaret Thatcher took office and led the implementation of monetarist policies in the UK. It was a role that Budd took over in 1991.

In the following years the Centre continued to play a part in providing analysis of the UK and international economy to the media, policy makers and business. In 1988, David Currie took over as director. He was followed by Andrew Sentance, who was director from 1995 until the Centre closed in 1997.

**From forecasting to ‘nowcasting’**

The School’s model had become less unique as personal computers became cheaper and more powerful. Financial institutions took on their own in-house economists who could produce their own forecasts with their own models. But today, the rise of big data has brought complex econometric models back into the spotlight.

By serendipity the School recruited a pioneer of the new models when it took on Professor Lucrezia Reichlin as Chair of Economics in 2008, from her position as Head of Research at the European Central Bank. Reichlin’s research started in the 1990s by trying to find a way through the sheer volume of economic information now available. The next development was to produce a ‘nowcast’ of the present state of economy, based on the idea that policy makers can’t wait months to know the state of economy using official statistics, they need to know it now. Her computer models sift through the vast range of economic news – from industrial production figures to consumer confidence surveys – which are all weighted according to their importance. Those ‘nowcasts’ are proving as accurate as human judgement. And, just like her predecessors at the School, her work has featured in the newspapers, including *The Times*. 

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