The toughest time for Terry Burns (now Lord Burns) and Alan Budd (now Sir Alan) was in March 1981 when The Times newspaper published a letter from 364 leading British economists condemning the UK government’s policies, rejecting monetarist thinking and urging a search for alternative approaches to end the country’s deepest recession since the Second World War. Burns and Budd, who’d done much to promote the ‘monetarist’ ideas at the centre of the debate, found themselves in a very small minority, pitted against their peers, in a country divided by economic turmoil and political hatred.

“It was one of those very difficult periods of life,” says Burns, who’d left London Business School to become the government’s chief economic advisor when Margaret Thatcher came to power in 1979. “People couldn’t believe I was prepared to work for the Thatcher government.”

The most hated man in Britain

And with Burns tucked away in the Treasury, Budd who was still at the School and talking about those monetarist ideas to newspapers and on TV, found himself in the firing line. “Mrs Thatcher was a very divisive lady,” he says. “And I was known by part of the press as Mrs Thatcher’s favourite economist even though I’d only met her on a few occasions and I’m not sure she knew who I was. I was at a party with a man who was deputy secretary of the Trade Union Congress and he looked at me and said: ‘I think you’re evil incarnate.’

“A friend in the US said he’d told people there that he knew me and one of them replied: ‘Isn’t he the most hated person in Britain?’”

But very soon after the economists’ letter, just when people least expected it, the economy started to recover. A little of that intense pressure was removed from the economic protagonists. Some of those 364 economists still dispute that they were wrong, but the government was left to get on with what it was doing and the shift to a new economic consensus was underway – one that has broadly lasted to this day.

How to explain inflation

Burns says he remains committed to the underlying ideas. Budd says that in economics you can never know you’re right, you can only present things as honestly as you can. But for both of them their thinking was rooted in their experience working with London Business School’s model of the British economy during the 1970s, when the economy started behaving in surprising ways.

At this time, amid huge economic pessimism in the US and Europe, added to by a tripling of oil prices, the UK had increasing unemployment, strikes and power cuts – at one point forcing the government to introduce a three-day week to limit power use. To make matters worse, by 1975 inflation peaked at 25 per cent.

“Inflation was a surprise to anyone who wasn’t a monetarist because at the same time unemployment was also rising,” says Budd. “In the way people thought about the economy up to then, the opposite should be happening – if unemployment was rising, inflation should be falling.

“It was at this time that the monetarists said we can tell you why it’s happening – it’s because the money supply is growing too quickly.”

Exploring monetary policy

Burns and Budd used the London Business School model to examine these ideas and see if they could find an enhanced role for monetary policy compared with fiscal policy. The model was pioneered by Jim Ball, one of the School’s founding professors, who recruited both men and went on to become Dean.

“Alan, Jim and I did a lot of work in trying to change and adjust our model to see what had created these circumstances,” says Burns. “So we spent a long time trying to incorporate monetary effects into the model.”

Their explanation was something that came to be called international monetarism – if you expand money supply too much it causes a depreciation of the currency, which in turn creates a wage and price spiral and raises inflation. Something Burns describes as “halfway in the debate between monetarism and the post-war Keynesian consensus”.

In 1976 the UK suffered the indignity of having to borrow money from the International Monetary Fund, the IMF. In return the IMF required the UK to control the money supply, domestic credit expansion and fiscal policy. This was in tune with Burns and Budds’ argument and model and started a shift of thinking in their direction.

Spreading the word

In 1977 Burns and Budd published an article in a journal they’d launched called Economic Outlook, which set out the concept of the medium-term financial plan. The idea was to create financial stability by limiting the kind of Keynesian-style fiscal policy measures that had previously been
used to try to stimulate demand from year to year, while at the same time reducing the growth of money supply to bring down inflation over a number of years.

Another important article argued that the exchange rate should be set free. In the past governments had tried to prevent the exchange rate from rising and Burns and Budd argued that it should be allowed to rise.

“We worked very hard to get our ideas across,” says Budd. “When a new edition of Economic Outlook was coming out we’d talk to journalists and explain our ideas.

“I spent a lot of time on TV and radio. In those days there was a TV programme called Weekend World and nearly every week it would be about economics for an hour.”

Ideas become policy
And their ideas reached higher levels too. Budd remembers that when the IMF and the Organisation for Economic Co-operation and Development came to Britain on annual inspections, they’d visit London Business School to get the economists’ view of what was happening.

By the end of the 1970s a consensus around monetarist ideas was building in Whitehall. The Labour government of James Callaghan had been forced to enact the policies recommended by the IMF and Callaghan famously said that you can’t spend your way out of recession. But when Margaret Thatcher’s Conservatives came to power in a highly ideological election, they stepped up the policy, made it part of their manifesto and monetarism became associated with them. In 1980, Geoffrey Howe implemented Burns and Budd’s Medium-Term Financial Strategy. And in the Budget of 1981 the government invoked the fury of many – including 364 of Britain’s economists – by tightening fiscal policy while the country was still suffering.

We know what happened next. Those events had such a searing impact on Budd that in 1991 when Burns moved on to run the Treasury and Budd stepped into his role as Chief Economic Advisor to the Treasury, he made it his mission to mend fences. “One of my ambitions in the job was to make economic policy bi-partisan, so you wouldn’t see a big shift in economic policy when the government changed,” he says. “I talked to people about policy, explained what we knew about what was happening in the economy, and that was quite successful.”

Most people would agree that we’re still within the framework of economic policy that emerged from the late 1970s. For a long period fiscal policy wasn’t used for demand management in the UK and the Bank of England was handed the job of using interest rates to control the growth of the economy. Fiscal measures came back into the frame with the financial crisis of 2007/8 but monetarist ideas could also be seen in the use of quantitative easing. “No one calls it monetarism any more,” says Budd. “Everyone’s pretty relaxed about it now.”

And while there were many other significant figures in the development of monetarist thinking in the UK, the economists of London Business School certainly played their part: “We were in the thick of it,” says Burns wryly.

Lord Burns was at London Business School from 1965 to 1979. He was the Director of the Centre for Economic Forecasting from 1976 to 1979 and from 1979, Professor of Economics.

Sir Alan Budd was at London Business School from 1974 to 1991. He was Professor of Economics and Director of the Centre for Economic Forecasting from 1979 to 1988.