Monetary trends in the United Kingdom

Note of a meeting of the Bank's Panel of Academic Consultants.

The Bank's Panel of Academic Consultants met on 28 October to discuss the book *Monetary Trends in the United States and the United Kingdom* by Milton Friedman and Anna Schwartz.(1) The Panel discussed only parts of the book relevant to the UK economy, about which the book makes strong claims; these were summarised by one participant as 'money causes prices, money does not cause output and nothing else causes prices or output'. In view of the importance for monetary policy of these claims, if true, the Bank felt they deserved full discussion by the Panel. For the meeting, the Bank invited two papers which discuss different aspects of the book. The first, by Professor Arthur Brown, considers how well the evidence in the book fits the UK historical experience. The second, by Professor David Hendry and Mr Neil Ericsson, examines the statistical procedures used by Friedman and Schwartz and the extent to which these enable the conclusions they drew to be substantiated. These papers, slightly revised in the light of the discussion, will shortly be issued as Panel Paper No 22. Copies will be available from the Bank at the address given on the reverse of the contents page of this *Bulletin*.

The statistical procedures in the detailed paper by Hendry and Ericsson will perhaps be unfamiliar to many readers, but the tests they report may be interpreted as answers to simple questions. These include: 'How well does the model fit?'; 'Is the relationship constant?'; 'Is there evidence that important influences have been omitted from the model?'; and 'How does the model compare with alternative models?'. Hendry and Ericsson contend that modern econometric techniques are not just a refinement of older techniques that were adequate for rough and ready purposes. On the contrary, they argue that proper application of modern techniques is essential if econometric study of time series is to be of any use. They conclude from their analysis that little can be learnt from the results in the book, since the evidence fails to support the claims Friedman and Schwartz make from it. This conclusion, as the authors emphasise, does not imply they are attacking the monetarist position, or that the model posited in the book has been shown to be necessarily wrong, but rather that it is not supported by the evidence presented.

Panel Paper No 22 also includes an introductory note by the Chairman of the Panel, Professor R C O Matthews, which summarises the discussion at the meeting. Topics covered include the relevance of institutional arrangements (especially the nature of the money creation process and the exchange rate regime) to an interpretation of the results in the book, and whether it is appropriate to try to estimate economic relationships over very long periods. The Panel also discussed the view expressed in Professor Brown's paper that short-run deviations about trend in output brought about by changes in the money supply could affect output in the long run; Professor Brown suggests that the important influence of money on output is through its effect on domestic capital formation. The Panel agreed that the evidence before it was inconclusive as between the main views on this issue, in part because Friedman and Schwartz had averaged the data before starting their analysis. But there was a strong body of opinion at the meeting that the short run could have an important influence on the long run.

(1) Published for the National Bureau of Economic Research by the University of Chicago Press, 1982.