The Grand Experiment

Mrs. Thatcher's Economy and How It Spread

CHRISTOPHER JOHNSON

The Grand Experiment

Mrs. Thatcher's Economy and How It Spread

Christopher Johnson

Westview Press
BOULDER • SAN FRANCISCO • OXFORD

Published in 1993 in the United States of America by Westview Press Inc
5500 Central Avenue Boulder Colorado 80301 2877

Library of Congress Cataloging in Publication Data
The grand experiment Mrs Thatcher s economy and how
it spread / by Christopher Johnson
p cm
Originally published London England New York
Penguin Books 1991
Includes bibliographical references and index
ISBN 0 8133 1913 7 — ISBN 0 8133 1914-5 (pbk)
1 Great Britain—Economic Policy—1945- I Title
HC 256 6 J63 1993
338 941 009 048—dc20 93 9937
CIP

Printed and bound in the United States of America

The paper used in this publication meets the requirements of the American National Standard for Permanence of Paper for Printed Library Materials Z39 48 1984

10 9 8 7 6 5 4 3 2 1

Contents

Preface 1

1 *Economic growth: can one succeed without really trying?* 5
Oliver Twist asks for more · The decline arrested – for how long? · Services output outstrips manufacturing · The fall and rise of the profit share · Private-sector demand outruns supply · A failure of demand management

2 *Inflation: the monetarist experiment that was never tried* 27
New cures for inflation · The Howe Chancellorship – the sheep that roared · The Lawson Chancellorship – the 'teenage scribbler' comes of age · Flying blind into the storm · Fiscal success, monetary failure

3 *Public expenditure: the enemy country* 76
Pick it up, put it down and shake it all around · Real terms and what was really spent · How expenditure was controlled · The choice of priorities and objectives

4 *Taxation: piecemeal reform of the system* 107
A tax-cutting manifesto · Income tax comes down · Keeping up with the NICs · Tax allowances – his and

hers • Tinkering with tax on savings • Incentives a shaky foundation for tax cuts • The corporation tax that wished inflation away • Poll tax – the peasants' revolt • The changing structure of taxes

5 *Privatization progress on some fronts* 144
Origins of a novel policy • Own sweet home • Mortgaging the future • Shrinkage of the rented sector • Moving on from the nationalized-industry battleground • How the monopolies were taken private • Private does not make perfect • Popular, but was it capitalism? • Selling the family silver

6 *Industrial performance miracle or mirage?* 177
'General post' at the DTI • Subsidies – the sun also rises • Takeovers – dangers of the middle way • Price competition – the paper tiger • Deregulation – the U-turn • Company statistics over-extended • Miss Rosy Scenario brings financial headaches • The balancing act collapses

7 *Labour the market that didn't work* 217
Conservatives divided on policy • Trade-union legislation – salami tactics • Fewer strikes but little effect on pay rises • Unemployment – first the solution, then the problem • Special job-creation measures • Working on the statistics

8 *Conclusions the curate's egg* 250
Defects and qualities of Mrs Thatcher's style • Successes and failures

Appendix Tables 265
References 319
Further reading 329
Index 331

Figures

1	GDP growth, 1970–89	12
2	Mortgage rates and bank base rates, 1979–90	71
3	RPI *inflation*, 1969–89	72
4	Planning totals, cash and real, 1974–88	90
5	General government expenditure and GDP, 1970–88	92
6	General government expenditure transfers, and goods and services, 1970–88	97
7	Taxation changes, 1979–90	111
8	Main tax rates, 1978–90	112
9	Share ownership, 1988	170
10	Ministerial changes at economic departments, 1979–90	179
11	Rates of return industrial and commercial companies 1960–89	200
12	Current external balances as percentage of GDP 1979–89	209
13	Non-oil trade volumes, percentage changes, 1980–89	210
14	Trade balances as percentage of GDP, 1979–89	211
15	Department of Employment activities, 1980–90	223

Tables

1	Economic growth trends, 1950–89	265
2	The UK and the Big Five growth comparisons in the 1980s	266
3	Labour and capital contributions to economic growth	267
4	GDP growth by industry	268
5	GDP by type of income	269
6	GDP growth by type of expenditure	270
7	Money GDP, output and prices	272
8	Fiscal and monetary stance of budgets	273
9	The results of monetary targetry	274
10	The public-sector borrowing requirement, forecasts and outcomes	276
11	Money GDP the split between prices and output	277
12	Taxation, public expenditure and borrowing	278
13	Monetary indicators	279
14	Inflation indicators	280
15	The UK and the Big Five inflation comparisons	281
16	Public expenditure, 1970–89	282
17	Public expenditure, cash plans and outcomes	284
18	Public expenditure, 'real-terms' plans and outcomes	285
19	General government expenditure as percentage of GDP, plans and outcomes	286
20	Changing priorities in public expenditure	287
21	Social security expenditure by groups of beneficiaries	288
22	The volume of general government expenditure	289
23	Public-sector job cuts	290
24	Public-sector capital expenditure, 1989–90	291
25	Tax revenue as percentage of GDP international comparisons, 1970–89	292
26	Tax allowance systems and costs	293
27	Gains from income-tax and NIC changes 1978–79 to 1990–91	294
28	Tax burden by income range, 1987	295
29	UK taxes as percentage of total taxation	296
30	Public-sector housing sales to owner-occupiers	297

31	Changes in housing tenure	298
32	Privatization and the public finances	299
33	Main corporations privatized	300
34	Performance of public corporations	301
35	Personal-sector wealth	301
36	The public sector in the economy	302
37	Government expenditure on trade and industry	302
38	Takeovers and mergers, overseas investment and capital spending	303
39	UK acquisitions for over £500 million, 1985 90	304
40	Gross trading profits and other business income by sector	305
41	Contributions to increase in business income	306
42	Gross domestic fixed-capital formation by sector	307
43	Industrial and commercial companies 1989 account	308
44	Industrial and commercial companies changes in assets, liabilities and ratios	309
45	The rise in the external deficit, 1984 89 forecast and actual	310
46	Export and import trends, 1980 89	311
47	Trade-union membership and stoppages	312
48	The rise in income inequality	313
49	International competitiveness comparisons	314
50	International unemployment comparisons	315
51	Employment creation	316
52	Changing employment patterns	318

Preface

This is not an economic history or an economic analysis, although it draws upon both disciplines. It is an attempt at political economy. It surveys the economic policies of the Thatcher Conservatives, from their intellectual origins in Opposition to their formulation in government papers and their implementation through three terms of office. It seeks to judge the appropriateness of the policies, the competence of their execution and the degree of their success in achieving the desired effects. Possible alternative policies are not discussed in detail, and we can now never know how they would have turned out. Appraisal of the Thatcher Government's policies, however, inevitably implies something about what the alternatives might have been, particularly those alternatives that members of the Government themselves seriously contemplated.

Although Mrs Thatcher herself was at all times the dominant figure in formulating and carrying out her Government's policies, she was the leader of a team with similar ideas, whose members held key posts. It is the actions and words of departmental ministers acting in her name, as much as her own words and actions, that therefore form the subject-matter of the book. Indeed, the source material for what the Prime Minister and her policy unit and key advisers were saying and thinking is scanty compared with the official papers and speeches of the main departments and their ministers. Some of Mrs Thatcher's remarks were in any case more by way of personal opposition to the line that she had resigned herself to allowing her Government to take.

It has not been possible to discuss the blow-by-blow details of policy implementation with the main participants, but some have already published valuable memoirs. A political history of this kind would have required a whole book to do justice to each chapter.

Rather than trying to cover the entire range of economic policies year by year, I have found it more illuminating to separate each main policy area and survey it over the decade, interrelating them by means of cross-references and in the conclusion. Inevitably, over half the book is devoted to policies for which the Treasury was responsible. Chapter 1 is about economic growth, for which no one in particular and everyone in general was responsible. Chapter 2 deals with the use of monetary and fiscal policy to control inflation. Chapters 3, 4 and 5 cover public expenditure, taxation and privatization, including home ownership. Chapter 6 is about industrial performance and the balance of payments and involves the Department(s) of Trade and Industry. Chapter 7 is about the closely connected topic of the labour market and involves the Department of Employment. Chapter 8 analyses the defects and qualities of Mrs Thatcher's style of government as it affected economic policy-making. It summarizes the findings of each chapter and tries to bring them together into a coherent verdict.

I make no apologies for drawing extensively on the reports of the Treasury and Civil Service Committee of the House of Commons, whose first decade of existence coincides with Mrs Thatcher's period in government. It was fortunate for the cause of open government that Mrs Thatcher allowed the select committees to be set up at the instigation of Norman St John-Stevas (now Lord St John of Fawsley), even though she may subsequently have regretted her decision. I apologize to the Select Committees on employment and on trade and industry, whose reports I have used much less, being relatively unfamiliar with their proceedings.

My work as a specialist adviser to the Treasury Committee, covering every Budget and Autumn Statement since late 1983, has given me a precious insight into the policy-making process. I here acknowledge the encouragement I have had from the two chairmen of the Committee, Sir Edward Du Cann (1979–83) and Terence Higgins (1983–), and the other members. The Committee's judgements, which seek to be tripartisan as far as possible, comment like a Greek chorus on the tragicomedy of the Government's economic policies. It may be assumed that when I quote the Committee's views I am in agreement with them; it would be tedious, if not improper, for me to specify which of them were the direct result of my advice.

I began writing this book in October 1990. Mrs Thatcher's resignation the following month made it all the more appropriate to attempt a summing-up of her three administrations, even if not all the statistics for 1990 are available as the book goes to print. Previous interim reports on Mrs Thatcher have inevitably had to contend with unexpected turns for the better – or the worse – after publication. Mrs Thatcher, OM, has quickly become part of history, even if it will require the history of the 1990s to be revealed before appraisals more definitive than the present work can be made. In view of the changes in ministers, and the substance as well as the style of policy, this book should be taken as a judgement not of John Major and his Government but of the legacy that they inherit.

I wish to acknowledge the opportunity that Lloyds Bank has given me to develop my ideas about economic policy in the *Lloyds Bank Economic Bulletin*, which began life in January 1979 and has thus covered the full span of three Thatcher terms. As well as inviting me to play the game of guessing in advance the contents of each Budget – a useful exercise in Treasury mind-reading – Lloyds Bank gave free rein to my comments on government economic policy. The bank – whatever that is – does not necessarily agree with the views expressed in this book, whose publication follows hard on the heels of my retirement from the post of the bank's Chief Economic Adviser.

In particular, I thank Patrick Foley, the Deputy Chief Economic Adviser, Teresa Fletcher, the Librarian, and her staff, Marcia Howard, my secretary, and David Thornhill, the chart artist, for their help with the book. I would also like to thank my publishers at Penguin: Andrew Franklin, who brought out *Measuring the Economy* in 1988 and encouraged me to write another book, and Ravi Mirchandani, who has given a welcoming reception to the idea of *The Economy Under Mrs Thatcher 1979–1990.* My wife, Anne, has supported me wonderfully, putting up with a husband who works all day at the office and all evening and all weekend at home.

A few notes on style for the reader are needed. I have deliberately not used footnotes because they disturb the narrative. Sources are either given in the text or should be easily identifiable from the references for each chapter at the end. The references should be taken not as a full survey of the voluminous literature on each topic but as lists of those sources referred to in the text or of particular significance in my own background reading. When a pair of years is given covering changes, it must be understood that the base year is the year before the first year of the pair. Thus the growth rate for 1980–89 is measured from base year 1979 to final year 1989, and 1980 is the first of the series of years in which the growth took place. Fractions are used to denote a number to the nearest one-quarter as opposed to decimals to one place, which denote it to the nearest 0.1.

Christopher Johnson
January 1991

I Economic growth: can one succeed without really trying?

'There always have been economic cycles, and there always will be economic cycles.'
Nigel Lawson, MP, Hansard, 23 October 1990

Oliver Twist asks for more

All governments want economic growth. This does not mean that they want the maximum quantity of growth in the short term at any price. The quality, the stability, the durability and the composition of growth are important subsidiary objectives. While voters are interested mainly in jobs, personal incomes and consumer spending, these are correlated with the growth of the economy as a whole. In any case forms of expenditure other than personal consumption, such as current government spending on services and capital investment in new products, also contribute to consumers' welfare to some degree.

The Conservative Government at first appeared to be the exception to the rule of 'growthmanship' because it adopted a roundabout strategy for growth in view of what it condemned as the failure of previous, more direct, approaches by its predecessors. The stability of growth was stressed in 1977 in *The Right Approach to the Economy*, which called for 'the provision of a more stable economic climate with as few sudden changes as possible'. This was understandable in the light of the change from 7.4 per cent growth in 1973 to −1.5 per cent in 1974. The 1979 manifesto, not to beat about the bush, called simply for 'an expanding economy'.

In June 1979 Sir Geoffrey Howe, the new Chancellor of the Exchequer, always a somewhat underrated practitioner of what might be called philosophical economy, sounded an agnostic note in his first Budget speech: 'There is a definite limit to our capacity, as politicians, to influence these things for the better . . . The notions of demand management, expanding public spending and "fine tuning" of the economy have now been tested almost to destruction.' He set out a four-point strategy 'to check Britain's economic decline'. He clearly meant relative, not absolute, decline. The aim was to raise the UK's growth rate again at least to the international average.

1 Incentives were to be strengthened by changes in the tax system, starting with the switch from income tax to VAT in that same Budget.
2 There was to be more freedom of individual choice and a reduction of the role of the state in the economy. There was thus to be a switch from public- to private-sector growth. This was argued for on the political grounds of greater market freedom and on the economic grounds of improved efficiency. It obviously precluded the use of the public sector to prime the pump for the growth of the economy as a whole, even in the good cause of offsetting the fluctuations of the private sector.
3 The burden of public-sector finance was to be reduced 'so as to leave room for commerce and industry to prosper'. The elimination of financial 'crowding out' aimed to lower interest rates for the private sector by reducing the public sector's call on the same financial markets.
4 It was necessary 'to ensure that those who take part in collective bargaining understand the consequences of their actions'.

This amounted to a switch of emphasis from demand-side to supply-side policies. It was only about halfway through its decade in office that the Government began to add education and training to the list of supply-side policies needed to improve the growth performance of the economy.

The Government's immediate preoccupation was to reduce rising inflation rather than to revive flagging growth. Its growth forecasts were extremely gloomy. 'After the recession forecast for 1980,' said Howe in his Budget speech in that year, 'the economy will grow by an average of only 1 per cent a year up to 1983–84.' Ministers made a virtue of necessity, arguing that lower inflation, far from being inimical to higher growth, was a precondition of it. The point was spelled out in the first version of the Medium-Term Financial Strategy (MTFS) in the March 1980 *Financial Statement and Budget Report* (Red Book), for which Nigel Lawson, then Financial Secretary to the Treasury, had a particular responsibility: 'The Government's objectives for the medium term are to bring down the rate of inflation and to create conditions for a sustainable growth of output and employment.' Clearly, growth had to be a medium-term and not a short-term objective. 'The process of reducing inflation almost inevitably entails some losses of output initially, though it promises a better growth of output in the longer term.'

In his 1981 Budget speech Howe made the same point, angled towards the growth of the private sector. His aim was to 'sustain the fight against inflation, and help redress the balance of the economy in favour of business and industry. It is only by giving priority to these objectives that we can strengthen the basis for sustained economic advance.'

The change in policy towards growth was sharpened into an intriguing paradox by Lawson in his Mais Lecture in June 1984, a year after he had taken over from Howe as Chancellor.

> The conventional post-war wisdom was that unemployment was a consequence of inadequate economic growth, and economic growth was to be secured by macro-economic policy – the fiscal stimulus of a large Budget deficit . . . Inflation, by contrast, was increasingly seen as a matter to be dealt with by micro-economic policy – the

panoply of controls and subsidies associated with the era of incomes policy' . . . There is indeed a proper distinction between the objectives of macro-economic and micro-economic policy . . . But the proper role of each is precisely the opposite of that assigned to it by the conventional post-war wisdom . . . It is the conquest of inflation, and not the pursuit of growth and employment, which is, or should be, the objective of macro-economic policy . . . And it is the creation of conditions conducive to growth and employment, and not the suppression of price rises, which is, or should be, the objective of micro-economic policy . . . This fundamentally important role reversal implies a major change in the nature of the macro and the micro policies themselves . . . Instead of monetary policy simply accommodating increased budget deficits . . . fiscal policy has to be in harmony with declining monetary growth . . . And instead of micro-economic policy consisting of increasingly numerous forms of intervention and interference with market forces, its role is now seen as removing controls and allowing markets to work better.

The Government was already departing from Nigel Lawson's role reversal of policies before he had publicly proclaimed it as Chancellor. By late 1982 inflation had fallen, and economic growth was beginning to recover. In his 1983 Budget speech, in the run-up to the general election, Howe could not resist the temptation to declare victory in a battle in which he had previously declined combat: 'Domestic demand has been growing at almost 3 per cent a year in real terms. This is a stronger growth of demand than in most other industrial countries.' Lawson continued to make similar claims during his next four years as Chancellor, which culminated in the proud boast of the 1987 general election manifesto: 'We have moved from the bottom to the top of the growth league of major European countries.' (The league did not include the more rapidly growing USA, Japan and some minor European countries.)

Although demand was back in fashion, from 1984 onwards the Government's objectives were set in terms of nominal, monetary demand, which includes both real growth and inflation, thus conveniently linking two main policy goals. The policy as stated in the March 1984 Red Book was thus consistent with that adopted at the outset of the MTFS in 1980: 'Lower cost and price inflation within a given financial framework makes room for faster growth of output and employment.' In 1985 the Government began the annual publication, in the March Red Book, of four-year projections of money Gross Domestic Product (GDP), which were to take over from targets for the growth of money itself as the main guide to policy. In the 1987 Red Book Lawson was able to put money GDP into the framework of his Mais Lecture: 'Monetary and fiscal policy are designed to reduce the growth of money GDP, so bringing down inflation. They are complemented by policies to encourage enterprise, efficiency and flexibility. These policies improve the division of money GDP growth between output growth and inflation and help the creation of jobs.'

Money GDP was to be minimized, in contrast to real GDP, which was to be maximized. It was thus a fundamentally different kind of objective, based on a controversial proposition in economics. The Government, while not necessarily seeking to increase the rate of real growth once it had recovered to a sustainable medium-term figure of $2\frac{1}{2}$–3 per cent, did not wish the deceleration of money GDP to bring about a corresponding slow-down in real GDP. The conflict had to be resolved by bringing down inflation – measured in this case by the GDP deflator – which would both arithmetically allow real growth to be higher within a given increase in money GDP and actually cause growth to rise by a benign economic mechanism.

In the 1984 Red Book it was held that a lower saving ratio by consumers, due to the reduction in the inflation rate, would stimulate growth. This was a demand-side argument in the Keynesian tradition, which was to be offset a few years later by supply-side lamentations about the lack of savings to finance investment. It was also argued more consistently that, once inflation had come down, interest rates would fall and would thus stimulate growth in the