

MAGGIE MIGHT MAKE LOTS OF MAGIC

Despite much current skepticism, there are reasons for arguing that Margaret Thatcher's rigorous conservatism may ultimately prove popular as well as corrective.

by HERBERT STEIN

Herbert Stein was chairman of the Council of Economic Advisers under Presidents Nixon and Ford. He now is A. Willis Robertson Professor of Economics at the University of Virginia and a senior fellow at the American Enterprise Institute for Public Policy Research in Washington, and he writes regularly for the Institute's monthly AEI Economist, from which this article is adapted. He recently spent three weeks in Great Britain, scanning the economy and interviewing government leaders, and came to a sanguine judgment of the Tory government's chances for future success—economically and politically.

Britain's new Prime Minister is a woman and a politician. Because she is a woman, it is easy to romanticize her as a Joan of Arc of conservatism, obedient to voices commanding that she free Britain from the Socialists and Keynesians. But because she is a politician, it is also easy to be skeptical of her. She could finally emerge as a

Prime Minister like many of her predecessors, prepared at the first whiff of adversity to sacrifice principle and to choose the soft policy options.

In my opinion, neither of these extreme views is altogether realistic. The Thatcher government will continue—and significantly accelerate—a change in British economic policy that began before it came to power and will last after it is gone. The result will be a major transformation in British policy and in British economic life, albeit one for which Mrs. Thatcher will not be solely responsible.

The Thatcher prescription

The Thatcher government faces a list of problems that are common in our times—slow economic growth, inflation, high taxes, poor government services, unemployment, disruption of economic life. But the Tory leadership also regards itself as called upon to deal with two other conditions not usually ranked so high in polit-

ical discussion. First, the regime is dedicated to restoring the work ethic, initiative, personal responsibility, and freedom. It stresses these values not only as spurs to G.N.P. growth but also as ends in themselves—quite simply the right way to live. Thatcher and her counselors do not like the extent to which the British rely on Big Brother—not only because Big Brother is inefficient but also because the reliance is intrinsically wrong.

Second, the government wants to correct what it regards as the intellectual errors that have dominated British thinking for the past forty years. It finds the Socialist and Keynesian doctrines by which Britain has been governed since World War II to be intellectually uncongenial and economically self-defeating. To replace these obnoxious doctrines, it is resolved to preach what it holds to be economic truth and sense.

The Thatcher idea of the "Right Approach" to economic policy rests upon a

number of key propositions. Specifically:

1. The Prime Minister and her advisers do not believe that real quantities—the levels of employment and unemployment, total output and its rate of growth—can be managed by manipulating monetary variables, such as the growth of nominal G.N.P. In particular, they reject the idea that full employment and rapid growth can be achieved by expansionist fiscal and monetary policy.

2. They reject "fine tuning" and believe it essential for the government to establish known lines of policy to which it will adhere and to which the private sector can adapt.

3. They reject "incomes policy" as a failed approach to the inflation problem and one that is inconsistent with the free market.

4. They are monetarists who hold that restraint in expansion of the money supply is the essential condition for achieving price-level stability. They also believe it is necessary for the government to keep the rate of growth of the money supply constant. And a reduction of the government deficit is essential to holding monetary growth within lower limits.

5. They want to reduce taxes to increase the freedom enjoyed by private citizens to dispose of their own earnings and to restore incentives for work, investment, and production. They are not Lafferites, and they do not believe that broad-based tax reduction will increase the revenue. Therefore, given the need to reduce the government deficit, the effecting of any substantial overall tax reduction will depend on restraining government expenditures. Even before that is achieved, however, it is possible and important to reform the tax structure by reducing the marginal tax rates on income and increasing the tax rates on consumption.

6. They want to hold down government expenditures not only to permit tax reduction but also to release resources from government employment, which clearly is one of the least efficient sectors of the British economy. They do not, however, intend any major contraction of the welfare state.

7. They propose to reduce government

subsidies for inefficient firms and industries, thus channeling resources into more efficient uses.

8. They want to curb the power of labor unions to disrupt production, discourage investment, and deprive workers of their individual rights.

This certainly does not read as a surprising agenda for a Conservative government. But what has been surprising so far has been the vigor and speed with which the Thatcher government has moved to advance its program in its first months in office. In four months, it has cut income taxes on the average by about 15 percent, including a cut in the top rate on earned incomes from 83 percent to 60 percent and on investment income from 98 percent to 75 percent. It has compensated for the resulting revenue loss by raising the value-added tax substantially. It has cut government expenditures by about 3 percent below the Callaghan budget, and it has announced its intention to sell about £1 billion worth of government investments in industry, such as British Airways and British Petroleum. It has raised interest rates sharply as part of its policy of restraining monetary growth. It has initiated a program for trimming down support for backward areas and has announced plans to introduce three pieces of legislation to curb the powers of labor unions and their leaders.

Grounds for skepticism

Despite the new government's exceptionally strong start, the conventional view is still that the Thatcher program will not "work." What that means is that the policy will not survive because, however beneficial its long-run results, the shorter-run consequences will be considered so adverse that it will become politically unsustainable, probably well before the end of Mrs. Thatcher's normal term of five years.

The scenario for this frustration of policy follows a certain logic. According to this script, the collision between the demands of labor unions for big wage increases and the government's policy of restraining monetary expansion will cause sharply rising unemployment. The unions will not re-

treat from their demands, and neither private nor public employers will be able to meet these demands without reducing the number of workers on their payrolls. Unemployment will also be increased by the government's policy of reducing subsidies for inefficient economic activity, thus causing layoffs in an economic environment where workers do not easily find new jobs.

Some forecasts see unemployment—now around 1.3 million—rising to two million by 1981. At the same time, the inflation rate will be high. The rate was more than 10 percent when the new government came in, and it is being boosted right now by the increase in the value-added tax. Even after that, the Treasury anticipates a rise in retail prices of around 14 percent in the next year, while other estimates range even higher.

Demand for results

As this skeptical scenario unfolds, the atmosphere will become dangerously charged with labor conflict. There will not only be struggles over wages and layoffs. The unions will also be roused to do battle against labor legislation that they regard as hostile and a government of which they are suspicious. The government has already made its easiest expenditure cuts without being able to make a net tax cut. Further expenditure cuts will be hard to achieve, and the government will be unable to meet the citizens' expectations of tax relief. Under these circumstances, there can be little improvement in the growth of real incomes.

Finally, there comes the political reckoning to end this dark prophecy. While the Thatcher government may discount these social ordeals as the birth pains of a brave new world, the British public will not look at them that way. The electorate did not vote for monetarist, libertarian, conservative theories. They voted for certain results. If these are not forthcoming, all devotion to an economic theory will fast wither. As the loss of public support appears in polls and by-elections, many Conservative members of Parliament will panic. Most of

them are not subscribers to Thatcherite theories. Politically, they want only to get along by going along. Concluding that they will not get along by going along with Margaret Thatcher, they will urge a turn to more moderate and less dogmatic policy—toward monetary expansion and incomes policy, and all that. And in the end either Mrs. Thatcher will bow to the party or the party will bow out by 1984.

Signs of realism

The sweep of this gloom vision does follow the terms of past experiences. Yet there are some persuasive reasons for thinking that the course of future events may well prove to be different.

A great deal depends on the quality of the inner circle of the new government. Here five figures are dominant. Sir Keith Joseph, sixty-one, an Oxford-educated businessman with toughly conservative fiscal views, set up Thatcher's pre-election brain trust, now heads the Department of Industry, and is widely regarded as a guru of the Thatcher team. The Chancellor of the Exchequer, fifty-two-year-old Sir Geoffrey Howe, is a once-liberal Tory who converted to the way of tight money. The Secretary of State for Trade is John Nott, forty-seven, once fired for economic inflexibility by the Edward Heath government. John Biffen, forty-eight, is an ardent conservative in the post of Chief Secretary to the Treasury, i.e., effectively the director of the budget. And he works closely with Nigel Lawson, forty-seven, another dedicated monetarist who is Financial Secretary to the Treasury. By and large, these men appear to be realistic ideologues. They have committed themselves so seriously as true believers in the libertarian, monetarist, conservative doctrine that it would be a great wrench privately—and a great embarrassment publicly—for them to veer off course.

The government's realism seems apparent, moreover, in its awareness that glowing results are not likely to be achieved quickly. Mrs. Thatcher and her associates have been cautious in their promises about controlling inflation and increasing real in-

come. Credibility is essential to the government's success, especially in the struggle against inflation. Here, the popular perception of the new leadership as being doctrinaire, and outside the usual political mold, can be an important asset. Moreover, the government has tried to nourish the trust that it means what it says. The radical shift in the tax structure, the big rise of interest rates, and the willingness to ride with a rising exchange rate—despite the moans of British exporters—are all signs of determination that the country recognizes.

While the skeptics recall that Conservative Prime Minister Heath made a U-turn in 1972, when he shifted to a policy of monetary expansion (following the example of President Nixon), it is wrong to assume that Thatcher will repeat the pattern. Heath's action is widely considered to have been a serious mistake, and Thatcher was swift to challenge him. The ability of this government to hold fast to its line is greatly strengthened by its forty-three-seat majority over other parties combined in the Commons. This fact makes it possible for Thatcher to lose a few dissidents and still count on having five years for her policies to reach fruition.

The uneasy triangle

The stubborn doubters commonly point to two rocks on which the government's policy is expected to founder—unemployment and the labor unions. By the standard theory of British political economy, the unemployment rate cannot be held down to a politically tolerable level without the accompaniment of either inflation or an incomes policy. But this doctrine assumes that the unemployment rate *can* be held to a politically acceptable level by either inflation or incomes policy. If this idea is rejected—and the Thatcherites do emphatically reject it—there is no choice or any temptation.

Even if one accepts the existence of the uneasy triangle of unemployment, inflation, and incomes policy—or accepts the fact that many people do believe in it—the government's policy need not necessarily

be frustrated. The present generation in Britain does not feel the same anxiety about other people's unemployment as their fathers felt in the 1920's and 1930's. There is more consciousness that some unemployment is voluntary, if not also deceitful. The ability of the Thatcher government to bear unemployment is reinforced by the nature of her constituency, which is not in the areas where unemployment is highest or likeliest—the economically backward and highly unionized north of England and Scotland.

Labor Party pains

Obviously, much will depend on the behavior of the labor unions. If they are adamant, they can aggravate unemployment and put the country through another painful period of industrial strife. The initial response of the union leadership to the government's policies has been vehement, but one still doesn't know how forceful the action will be. The union leadership must recognize that the unions' obstinacy and callousness last winter had much to do with Labor's loss in the 1979 election. The unions have been cast by many in the role of enemies of the people. The leaders do not like that personally, and they realize that it is bad for their organizations. They also recognize that this government is here to stay for a while and is very determined. If pushed too hard, the government could get through union-restrictive legislation more severe than what it has already proposed.

The apparent weakness of the Labor Party further enhances the chances for the Thatcher government to carry on its policy for its statutory term and to retain a good possibility of reelection in 1984. The Labor Party is sharply divided into its conservative and radical factions. The conservative wing of the party, which managed the government for the past five years, has run out of distinctively "Labor" solutions for Britain's problems. What it essentially offers as an alternative to the Tories is a promise to do the same things as they do more gradually, cautiously, and pragmatically. This is unlikely to stir the voters.

unless the results of Tory policy are disastrous. As for the radical wing of the party, it seems to offer nothing but symbolic acts, like abolishing the House of Lords or establishing more machinery for economic planning, which are irrelevant to Britain's immediate problems.

I have suggested some reasons for thinking that the policies of the Thatcher government will have more public support than they might have had some years earlier. The experience of the recent past—and the passage of time since the Great Depression—have made the public both more tolerant of unemployment and more resentful of inflation and high taxes than they used to be. The sympathy for unions and their leadership has notably diminished. There is a large and growing number of people—mainly situated in the south of England, employed in technologically modern industries, and largely untied to labor unions—who are less worried about unemployment than people elsewhere and form a reliable core of Conservative party support.

Although the average Englishman knows little of conservative economic ideology, and certainly is not devoted to it, neither is he immersed in a flood of propaganda hostile to it. The British voter does not know much about the economic theories guiding Mrs. Thatcher and her advisers, but he does not know much against them either. Conceivably, what will get through to the public is that these theories are modern, fashionable, scientific, and not at all to be disdained.

A little bit of luck

The ability of the government to stick to its line of economic policy during its five-year term, and to get reelected, may not entirely depend on economic results, unless these are catastrophic. As Sir Keith Joseph has said, by way of explaining how the government might survive even if it fails to deliver much economic improvement in the next years: "Economic policy will have to be conveyed by social policy." The British voters are affected by many issues other than strictly economic

ones. They are interested in law and order, capital punishment, abortion, immigration and race relations, the quality of medical care, and education, among other things. On most of these issues, the positions of the Conservative party in the 1979 election seemed to be close to the sentiments of the British majority. If the Conservatives can maintain this posture, the public may give Mrs. Thatcher a chance to continue her experiment, even without its producing any immediately dazzling economic results.

Great ventures rarely succeed without at least a little bit of luck, and there are several sources from which Mrs. Thatcher's luck can come. The most nearly assured source is oil. Its increasing production will make a large and rising contribution of revenue to the Treasury over the next few years. By 1983-84, this sum may reach about £6 billion a year—or about 8 percent of the present level of government spending. Such a bounty could be extremely helpful in allowing the government to make some tax cuts and simultaneously to reduce the deficit. Already, this prospect has raised the exchange rate of the pound—a development which holds down the costs of imports and assists in restraining British inflation.

Avoiding political disaster

It is a good bet, I think, that the Thatcher government will stick to its announced policies through the five years of its normal term in office. Even the most enthusiastic Thatcherites do not think that this term in power will suffice to correct deficiencies in a British economy that they consider to be 100 years old. But some things will have been accomplished.

The Conservatives will have demonstrated that it is possible to adhere to a policy of slow expansion of demand, implemented by monetary restraint, without results that are disastrous either politically or economically. Five years of British Conservative policy can make monetarism the standard doctrine. The government will also have made an irreversible step toward changing some of the structural conditions

that have for so long bedeviled the British economy. The ridiculously high top marginal rates of income tax already have been substantially reduced. Following the action, there was no outcry that this was favoritism for the rich, and it seems unlikely that such tax rates would be restored under any future government.

Five years from now, furthermore, this Conservative government will have borne the brunt of the transitional pains connected with trimming down subsidies for the support of inefficient industries, and it may have demonstrated to its successors that the way to avoid such pain in the future is to refrain from the subsidies in the first place. Also, the power of labor unions will have been somewhat reduced by new labor legislation. In these circumstances, union leadership will have lost its position as a dominant authority and claimant in the British society and will have settled into a more balanced relationship with other elements in the private sector.

Creating a new atmosphere

The full Thatcher agenda, however, will not have been completed. There will not have been a big change in the size of the budget, relative to the national income, and there will not have been a big reduction in the total tax burden. The present generation of British businessmen probably will still not have acquired new willingness to take risks and to innovate. If any change is achieved in the long-term rate of growth of productivity, it will have been small, and obscured by short-run fluctuations. How much time must pass before there is clear improvement in the growth rate—and how big this improvement may be—are questions that no economist today can predict with confidence.

Yet even if the visible results in measured G.N.P. are small, the British may have discovered that the atmosphere of personal responsibility, competition, and freedom that the Thatcher government is creating is valuable in itself. If so, no government will soon turn in a different direction. □