

Prime Minister (4)

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An Open Letter to President Reagan

By Sir Alan Walters

Dear Mr. President,

As you prepare your "State of the Union" address, you will certainly pause to reflect on the future of the economy. At the same time you will be bombarded with advice from political "pragmatists" who will seek to persuade you that changing political and economic conditions warrant a change in the course of economic policy. I would urge you, however, to resist the songs of such sirens.

As a former economic adviser to Prime Minister Margaret Thatcher, I believe that experience of Britain holds many lessons for Americans. Chief among those lessons is that a resolute policy breeds credibility; and that credibility is essential to the achievement of needed economic reform.

The predominant characteristic of governments before Mrs. Thatcher was their accommodating flexibility. Pre-Thatcher governments, both Labour and Conservative, were not encumbered with ideological baggage. They were pragmatists. They shifted their policies and the grounds on which they justified them, with quite remarkable adeptness. After all, it was argued, circumstances change: and so policies should be adapted flexibly to take on board the new conditions.

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Mrs. Thatcher's policy was to replace this wobbly jello-like flexibility with firmness and resolution. In essence the Thatcher policy was set out in a series of rules or, as her political enemies continue to call them, doctrinaire rigidities.

First, and fundamental, was financial control. In Britain this implied not only control over the money supply but also a persistent downward trend in the budget deficits, as a fraction of GNP. Second, state spending was to be reduced to an extent that allowed rates of taxation to be progressively diminished so as to restore incentives and enterprise. Third, there was to be a reduction in controls and regulations in both firms and families. Fourth, there was to be a progressive policy of selling off the nationalized industries and returning them to private ownership and control.

The ultimate objective of Mrs. Thatcher's policies was to foster a new energetic, enterprising and productive, but non-inflationary, economy. Just so, Mr. President, you might have described your own goals for the United States.

So what is the score thus far?

On the first objective, financial control, the British performance has been very good -- scoring perhaps eight or even nine points out of a possible ten. Britain is one of the few countries in OECD that does not have a budget deficit problem. Furthermore, the slow (5 percent) growth of the monetary base over the four years ensured that inflation would fall from its peak of 23 percent in 1980 to the 5 percent experienced today. The proof of the pudding indeed!

On the second objective, the reduction of spending and taxes, the score for the first four years is much lower -- a modest five out of ten is appropriate. The British government found it difficult to arrest the growth of public spending. The underlying and continuing causes of the relentless rise

of public spending are the "demand-driven" expenditures, or as they are called in the United States, the "entitlement programs."

The government of 1979-1983 put a brake on the creation of new entitlements and new programs. It did something, but not very much, to arrest the rapid natural growth of existing welfare and other services. But just as in the United States and many other Western democracies, this remains the most serious unfinished business. Unless the burden is relieved, the West will be the first civilization to collapse under the weight of its good intentions.

Meanwhile, the burgeoning public programs have to be paid for out of taxation or borrowing. In a great act of statesmanship, the chancellor and the prime minister decided to finance it "honestly" through increased taxes. In 1981 they instituted a very tough budget. The reward came later as the economy started to grow from mid 1981. In both 1982 and 1983 the chancellor was able to reduce taxes substantially yet maintain the principle of "honest finance." Taxes are still expected to be reduced rather than increased. I hope that you too will take steps to bring the United States back to the morality of honest finance.

On the third objective, the reduction of regulation, I would score a relatively high seven out of ten. The program began most auspiciously -- "at a stroke" Mrs. Thatcher abolished exchange controls in 1979. The elimination of general wage and price controls followed quickly upon the election. Deregulation worked; and it was obvious it worked well. There was no popular demand for reinstatement of these controls.

With the last objective, the program of denationalization, we can score not more than six out of ten. The main criticism is that it proceeded too slowly. Yet in the second Thatcher government, many of the great nationalized concerns, such as telecommunications and British Airways, will be sold off and subject to the private disciplines of the market.

Mrs. Thatcher's first four years may therefore be judged a solid if spotty achievement. But what about the costs of Thatcherism? The most obvious -- and what would seem to be politically the most damaging -- is the increase in unemployment from about 1.3 million in 1979 to 3 million in 1983: from 5.5 percent to 13 percent.

British labor leaders, who ignored the Thatcher government's pledge to reduce inflation and negotiated 20 percent increases in wages and salaries in 1979, discovered that their folly priced British labor out of the competitive market. Wage awards since 1980 have fallen dramatically, reflecting a "realism" that has at last begun to reduce unemployment. More important, this "realism" shows a new faith in the credibility of the government's economic policy.

Governments are not born with the silver tongue of credibility. They have to earn it. It is acquired in the hard school of experience. And such credibility is more difficult to earn when history is replete with failures of both nerve and resolve.

The Thatcher government has achieved that rare credibility and reelection required to continue the great reform of the British economy.

In 1984, Mr. President, that same achievement is within your grasp.

Respectfully,


Alan Walters