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Thatcherism Works

"Instead of sinking further and more rapidly into the slough of depression and despair, the impossible occurred."

In March 1981, the British Conservative government raised taxes substantially in a dramatically tough budget. The proposals were greeted with a mixture of rage and indignation, and forecasts of economic collapse. The political wiseacres thought that this heralded the end of Margaret Thatcher. The "wets" (those Conservatives who were opposed to the stringent economic policies of Thatcher) were voicing ominously their criticism and "concern." Here was a budget "dry" as tinder and just as inflammatory.

Calls for reflation rather than retrenchment were loud in the land. Academic economists—including the "great and the good"—were almost unanimous in condemning the Thatcher policies. In a letter to the Times, no less than 364 said that the government's policies had "no basis in economic theory or supporting evidence" that "present policies will deepen the depression, erode the industrial base of our economy and threaten its social and political stability," and that alternative policies (of reflation) should be adopted forthwith. The call was for an increase in government spending and, if anything, a reduction of taxes. This would have the effect of increasing demand and reflating the economy. The Labor Party echoed and amplified this chorus of reflators for this depressed economy.

Since all forecasts expected that the price level would be increasing at roughly the rate it had increased in the previous year—namely about 11 percent—the call for "reflation" may seem a bit odd. But it was more than a corruption of the English language. Groves academe were bristling because Britain was sinking into a slump. Output was falling steeply and unemployment rising sharply. Conventional economic doctrine taught that the only way to prevent an economy slipping further into the abyss of depression was to expand spending, lower taxes and increase the budgetary deficit. Borrow more and spend more—that was the prescribed medicine. And what of the 11 percent inflation? That was thought to be of secondary importance and could be contained by regulations.

The government, however, remained skeptical, if not cynical, about the prescriptions of such economists. After all, these policies of borrow-and-spend, with intermittent income controls, had been pursued from the mid-1960s when unemployment had normally been about 500,000 through to the early 1970s when it rose to about 1 million, finally entering the decade of the 1980s with 2 million on the dole. The

prescription had failed to produce jobs, but it certainly induced more inflation. By the middle of 1980, inflation had reached a peak of 23 percent per annum. Perhaps, therefore, the government may be forgiven for regarding the obloquy of academic economists not with alarm but rather as a featherweight of confirmation that its policies were appropriate.

Confirmation of a more substantial kind came as the year of 1981 progressed. Instead of sinking further and more rapidly into the slough of depression and despair, the impossible occurred. By the summer of 1981 not only had output stopped falling, but the level of production showed an unmistakable upward surge. And in spite of the sharp decline in the United States, Germany and Italy in 1982, Britain's output increased faster than that of

all other OECD countries combined. Even more, remarkably, in spite of a very high value of sterling in 1980-81, Britain increased its share of world manufactured exports in 1982. Meanwhile, inflation fell faster than almost anyone had predicted. This was quite a performance for the typically moribund British economy. Meanwhile, the recovery continues in 1983 at a steady sustainable pace.

There is wide agreement that the 1981 budget established the essential *credibility* of Thatcher's government and its policy. There was to be no more drift into higher deficits and, after monetization, into higher inflation; no validating extravagant wage increases or preposterous investments. The establishment of this credibility was the foundation of the economic and political success of Thatcher's leadership. She meant what she had said—no more but certainly no less.

A second effect of the budget was the easing of conditions in credit markets and the concomitant reductions in interest rates. From November 1980 to March 1981 they had been reduced by 4 percentage points—and for the first time for many a year they fell substantially below interest rates in the United States. Most important, for the next three years the government never suffered a "funding crisis"—those depressing events when interest rates soared in order to overcome the lack of confidence of markets in the ability of government properly to fund its deficit. The long bull market began in the spring of 1981.

Measured by results, the budget of 1981 was a substantial economic and political success. The upturn in the economy in mid-1981 was followed by the rise of Thatcher in the polls of February 1982. It really did appear that the British had acquired a leader of integrity, sincerity and immense moral courage. That was something to be thankful for in the years ahead.

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