The Political Economy of Thatcherism  
(Part I)

Wolfgang Brassloff

1. Introduction

For nearly two decades Britain has been governed by the Conservative (Tory) Party or, rather more precisely, by a wing of the party that has brought a distinctive approach to bear on the management of politics, economics and society. This approach has by now become instantly recognisable all over the world as “thatcherism”, although there is much about its precise nature that remains in active dispute. Here it seen as a complex and in many ways contradictory phenomenon, an application of New Right instincts to a project that conflates elements of British neo-conservatism with elements of European neo-liberalism. In a turbulent and, for a large section of the population, painful period, ideology-driven domestic preoccupations and general, often international, trends and developments have interacted strongly and resulted in profound transformations, some of which are widely considered to be irreversible. This is partly so since, while there is widespread resentment of the changes brought about by thatcherism, much of which has done great damage to British society and the British economy, there is little visible evidence of a clear alternative. The post-war British and West European social-democratic movement, having successfully, even if evidently only temporarily, “civilised” capitalism, in part under the competitive pressure of Soviet-style socialism, however impoverished and ultimately dead-end, ran out of steam and has not yet developed a new and inspiring socio-economic vision after “really existing socialism” collapsed and – however illogically – discredited the entire socialist idea. Even so, for all the political and electoral success it had achieved, the thatcherite project seems to have both exhausted and over-reached itself and may very well be self-destructing.
A critical analysis of some of the main lines of development appears useful, not least because of the way various local versions of ultra-liberal tenets and prescriptions appear to be spreading in the European Union and the individual countries of Europe, East and West, where of course similar social forces share similar material and ideological interests, and face similar global challenges. Not only this: thatcherism is presented by its British supporters as a social and economic model for the continent and has in fact acted as a trail-blazer and as an alibi for right-wing (revisionist) developments in Europe.

Debate of the issues is also timely because Britain is in the throes of an – as yet undeclared – pre-electoral campaign, the outcome of which will decide whether, and to what extent, present policies will continue. In 1990 these policies were widely expected to change dramatically when John Major succeeded Margaret Thatcher as party leader and Prime Minister. Mrs. Thatcher had to go as she and some of her more extreme policies had become so unpopular in the country that many of the back-bench Tory MPs and of her Cabinet colleagues were convinced that she had, in the words of Nigel Lawson, the architect of her economic strategy, “become an electoral liability and that the Conservative Party could win the coming general election only under a new leader” (1). The opinion polls did indeed – if only temporarily – improve for the Tories after her resignation; they went on to win the 1992 election, although only just.

Major was at first credited with having skilfully retreated from full-blooded thatcherism (2). At that moment one analyst believed that the establishment of a new broad policy consensus was a realistic possibility between a Labour Party, that had discarded much of its former image – and some of its principles – in order to adjust to development in British society and to make itself “electable”, and a diluted version of thatcherism more closely resembling traditional conservatism (3). But since then John Major has progressively readopted the entire Thatcher agenda partly under pressure of small but powerful – to an extent overlapping – groups of Thatcher super-loyalists, ultra-rightwingers and “eurosceptic” (really europhobic) Conservative members of Parliament. Their influence was given extra strength by the fact that the government’s original overall majority in Parliament of about twenty was fast disappearing as three MPs “defected” and as all by-elections arising out of the death of Conservative parliamentarians were lost, reflecting the government’s present unpopularity and a public perception of the Tories as incompetent, divided and mired in sleaze.

By April 1996 the government’s majority was down to just one. As a consequence, Mr. Major is dependent on the support of the Northern Ireland Unionists who are strongly conservative, but have their own tribal concerns, and he may be forced into an election date in the Autumn of 1996 instead of in Spring 1997, the latest that a poll has to be held. He had hoped that by that time improved economic conditions of the cyclical recovery would at long last call forth an up-to-now elusive “feel-good factor”.

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Major’s lurch back to a much more extreme Right has been acknowledged by Mrs. Thatcher who, in a well-publicised speech to the party faithful, reversed earlier criticism and endorsed him as a “leader who shares [my] broad analysis” (4). That leaves the whole period since 1979 basically unbroken as to ideology and basic societal objectives and allows us to speak of thatcherite government throughout. In some areas Major has, in spite of his very different style of government, actually out-thatched Thatcher.

This article documents and analyses the economic record and some of the social and political implications of the Thatcher era, the way in which and the extent to which her project was realised and the resulting benefits and costs. In addition, an overall assessment is made as to whether the radical changes introduced by thatcherism have made British society more cohesive and more self-confident and the British economy stronger, more resilient and better equipped to face the present difficulties and the future challenges.

After all, when Mrs. Thatcher captured the leadership of the Conservative Party in 1975 (some thought she hijacked it) while in opposition, and then won the general election and formed her first government in 1979, the proclaimed objective was clear: to change fundamentally the values and structures of Britain in order to halt and reverse Britain’s economic decline relative to the rest of Western Europe and Britain’s absolute decline as a world influence; in Mrs. Thatcher’s words, to put “Great” back into Great Britain, and to “re-unite a divided and disillusioned people” (5).

2. Undoing the past

What the thatcherites intended had been to overturn the post-war accommodation that had reflected a modest but definite shift of power away from the discredited social forces that had dominated the dismal inter-war period. The new dispensation, expressed through the Labour government led by Clement Attlee, had brought credible and successful government commitments to ensure full employment and job security, based on stable economic development, a mixed economy and a Welfare State. But growth, while quite respectable in historical terms, never succeeded in equalling the “economic miracle” performance of the rest of Western Europe (arguably because of the persistence of “superpower” pretensions and the associated diversion of valuable resources from potential civilian to military uses) and so gave credibility to the notion of “relative economic decline.”

Even so, what was clearly an important albeit not absolute success had created a strong constituency in favour of maintaining the basic value and policy system created by Labour. As a consequence, in the early 1950s the Conservatives had to discard much of their free-market economic and industrial approach “to make themselves electable” (6)
although a small band of right-wingers and economic liberals (Friedrich Hayek gave them a theory-based alibi and a coherent political philosophy) remained unappeased.

Many differences persisted between the political parties as to policy priorities but a basic consensus developed: “Butskellism”. (7) According to one analyst, this consensus was facilitated by “Labour’s retreat from further nationalisation and state planning after the economic body blows it suffered in 1947” (8). In the “historic compromise” the Conservatives accepted a mixed economy (that included a strong nationalised sector) and the Welfare State, while Labour did not question the continued existence of the capitalist system. The “Golden Age” (9), “a capitalism without losers” (10) which ensued, and with it the broad political consensus, collapsed in the mid-1970s under the strains caused by world-wide “stagflation”, the associated intensification of the distributional conflict and ideological counter-revolution of the New Right (which Bruno Kreisky considered to be not really all that “new”). To this, the practitioners of the prevalent “vulgar” version of Keynesianism (Joan Robinson’s description) had no answer.

It was the now-crumbling post-war consensus that Mrs. Thatcher and her associates vowed to destroy completely. In her eyes all post-war governments, whether Labour or Conservative, had been basically social democratic and they had done no more than “manage decline”; though she was well aware of it (11) she was publicly ignoring the fact that Britain’s relative decline had been in evidence for a century, since the – free market – 1880s and she would not or could not acknowledge that in the first three post-war decades the performance of the “over-regulated”, “socialist”, British economy had been in all ways vastly superior to that of the inter-war period and that British society was very much more contented and cohesive. But for the representatives of capital the postwar changes had gone too far and they felt threatened. So when the profit squeeze came they set about in the later 1970s and the 1980s in Britain as all over Western Europe to protect, restore, indeed extend the “prerogatives of capital” (12) and in Britain they succeeded to a greater extent than elsewhere in Western Europe. Instead of maintaining a “mixed economy”, the thatcherites would sell off the state enterprises and “set the market free” by a thoroughgoing programme of deregulation of product and labour markets; this was expected to create a flourishing “enterprise culture”. They strongly furthered the process of “globalisation” which everywhere weakened the position of labour and progressive movements, the perception of which “robs us of hope” and the political impact of which “one can only call the pathology of over-diminished expectations” (13). At the same time, the thatcherites used globalisation as an alibi for their own preferred strategies. Hirst and Thomson see the “rhetoric” of globalisation as “based on an anti-political liberalism”, “a godsend” for the Right in the advanced industrial countries, which provides a new lease of life after the “disastrous failure of their monetarist and radical individualist policy experiments.
of the 1980s', while they claim that it has rendered reformist strategies of the Left "obsolete" (14).

The Thatcher government found neo-classical economics generally and "monetarism" and "supply-side" economics specifically in tune with its ideological preoccupations. A myth was created that Mrs. Thatcher and her associates had, while still in opposition, "worked out a full programme for government" (15) which in office they pursued consistently and with full success. In reality, the Thatcher period was characterised by the "persistence of intractable problems" (16) such as slow growth and high unemployment, the ongoing contraction of manufacturing capacity, repeated bouts of high inflation and balance of payments problems. The thatcherites had mocked as "fine tuning" the attempts by the governments that preceded them to stabilise demand and output, leading to "stop-go" (or, more correctly, "go-stop") economic phases of the 1950s and 1960s. But the thatcherites turned them into the much more virulent "boom and bust" phases of the 1980s and 1990s. Nor did the Thatcher period see the unfolding of a master plan. The government changed tack several times as earlier strategies came to grief, but never acknowledged it: substance changed, the rhetoric persisted.

Take monetary policy, the central and "magic" ingredient of thatcherite micro-steering: setting targets for the (generally to be reduced) growth of the money supply over a number of years ahead to eliminate inflationary expectations (the "Medium-Term Financial Strategy") would do away with booms and slumps, assuring stability of growth. Monetary targets would be set and adhered to by cash-limited (mostly reduced) public expenditure, controlling government demand for credit. Variations of interest rates would control demand for credit by the private sector. (This system had, in fact, in essence been first introduced by the Labour government of the late 1970s, following a particularly severe sterling crisis, under pressure from the IMF. One analyst has even suggested that, with the arrival of the IMF loan monitors in London, "thatcherism took office . . . in 1976" (17). Mrs. Thatcher's government was not formed until 1979.)

However, in the first two years, responding uncritically to (often misleading) signals given out by the changes in the growth of monetary aggregates, Mrs. Thatcher's ministers, in order to tighten policy, set ever higher levels of interest rates, which contributed to an inappropriate appreciation of the currency: the "petro-pound". High interest and exchange rates combined to reduce British industrial competitiveness at a time when the world conjunctural conditions were deteriorating, and pushed Britain into an unnecessarily deep and prolonged recession. Between 1978 and 1981 relative export prices rose by nearly 20% and relative unit costs by 50% (!) (18). Output fell sharply, one-fifth of the manufacturing sector disappeared never to return and in eighteen months unemployment doubled to over three million. The Thatcher government had inherited a (declining) rate of 4% in 1979; in 1981 it averaged 8.3%. By 1985 it had reached 11% (19).
But by then the government had (secretly) given up on monetarism. Its anti-inflationary policy was now “largely rudderless” (20). “Unthinking monetarism” (21) was followed by a less dogmatic, discretionary approach to the management of the economy via a variable mix of monetary and fiscal policies, the very pre-Thatcher strategy about which the thatcherites had been so dismissive. It brought a brief period of modest growth and low inflation.

When Lawson returned to the Treasury after the 1983 election, dogma was “in” again. In his Mais lecture of June 1984, he proclaimed a cross-over from what he called the conventional post-war wisdom, in which macro-economic policy was assigned to promote growth and micro (including incomes) policy to suppress inflation: now the suppression of inflation was to be the task of macro (mainly monetary) policy while micro (supply-side) policy, mainly tax and labour market reform, would provide the conditions favourable to improved performance in terms of growth and employment, which were now considered outside the proper direct responsibility of government. There was an implied allusion to the claim that a succession of pre-Thatcher governments had allowed the country to become “ungovernable” (22), presumably because decades of full employment had shifted the balance of power too far from managers to workers and had brought “excessive” job security and wage rises.

But by the mid-1980s inflation had risen again sharply and the government escaped by making the Deutsche Mark (instead of the money supply) the target variable for the conduct of British monetary policy and so handed over its disinflationary policy to the Bundesbank. This was reinforced when the pound entered the Exchange Rate Mechanism (ERM) of the European Monetary system (EMS) in October 1990. When that strategy collapsed also, in September 1992, a new phase of more pragmatic – quite unthatcherlike – way of steering the economy ensued, though again only briefly (See Section 10).

3. The economic record: an overview

Table 1 sets out some selected key data to show how the economy has in fact performed: clearly the overall objective of decisively improving on the past was in no way achieved: economic growth did recover marginally from the – internationally – dismal second half of the 1970s, but it remained much inferior to the pre-Thatcher 1960s. Rates of unemployment and of inflation were also very much higher under Thatcher than they had been before.

In international terms the growth rate remained below, unemployment above, inflation marginally above, that of the EU between 1979 and 1996: the government’s claim that the deregulated British economy “has been out-performing” all the more regulated countries of Europe (23) does not square with the facts. What is true, however, is that the negative differential has shrunk as performances have deteriorated in traditio-
nally successful European countries: the smaller gap was not due to British improvement, but to EU deterioration; not a case of “catch up” but one of “catch down”.

Table 1:

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<tbody>
<tr>
<td>Real GDP (annual average growth rates)</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Britain</td>
<td>3.2</td>
<td>1.5</td>
<td>2.6</td>
<td>1.9</td>
</tr>
<tr>
<td>EU</td>
<td>4.8</td>
<td>2.5</td>
<td>4.1</td>
<td>2.1</td>
</tr>
<tr>
<td>Unemployment Rates</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Britain</td>
<td>*3.2</td>
<td>5.1</td>
<td>4.0</td>
<td>9.0</td>
</tr>
<tr>
<td>EU</td>
<td>*1.5</td>
<td>*3.7</td>
<td>*2.2</td>
<td>8.7</td>
</tr>
<tr>
<td>Inflation Rates</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Britain</td>
<td>5.2</td>
<td>15.6</td>
<td>8.5</td>
<td>6.5</td>
</tr>
<tr>
<td>EU</td>
<td>4.6</td>
<td>10.9</td>
<td>6.6</td>
<td>6.4</td>
</tr>
</tbody>
</table>

Source: OECD.
* Not strictly comparable.

In addition the indicators conceal – as averages – fluctuations in economic activity, which in the 1980s were very much more pronounced than they had been in the 1960s, and also than those of most other countries. Inflation spiralled, fell, and spiralled once more over the years and so did unemployment, while Gdp growth rates first plummetted, then rose, and finally fell sharply again. In 1996, Gdp growth is marginally higher than in other large economies of the EU (in part thanks to their attempts to attain the EMU convergence criteria) but well below its long-term production potential. The government had undertaken to “squeeze out” inflation and to end for good inflationary expectations: basing itself on the ideologically convenient natural rate of unemployment approach, the concept of “non-accelerating inflation rate of unemployment” (which conveniently implies that there are clear limits to a government’s capability of lowering unemployment); it claimed that the cost in terms of growth foregone and of unemployment would be strictly limited and temporary and that growth and employment would then rise strongly. But this did not happen: the massive rise in unemployment had itself worsened the economic environment, reduced labour skills and productive capacities and raised the “natural rate”. Employment and unemployment never recovered fully, even long after the presumed causes of low employment and high unemployment had been overcome. Altogether, we see a very mediocre economic performance, in stark
conflict with the claims made for it. There is certainly no evidence of a British "economic miracle". Some observers have found it possible to discern a relatively satisfactory performance – even a "renaissance" or a "miracle" – by considering exclusively the years of the – international – conjunctural upswing of the 1980s and ignoring the two unduly long and severe recessions preceding and following it, either because of the timing of their analyses or because of their pro-Thatcher bias.

And yet one could and should have expected an economic renaissance as resources and opportunities appeared in the 1980s that had not been available to earlier generations and that were not available to Britain’s European neighbours: the coming onstream of ever greater quantities of North Sea oil and gas made Britain self-sufficient and even a net exporter of oil products at a time when West Europe’s economic development was severely dampened by the price rises of the second oil price shock. Vast financial resources became available to Britain to underwrite economic expansion by the modernisation and re-equipment of industry – however the mechanism used – and by an improvement of the human and physical infrastructure. To gauge the extent of the windfall for the British economy: by 1985 North Sea oil and gas accounted for 5.5% of Gdp, 5% of capital investment, 8% of exports and 8.5% of tax revenues. (24) But in pursuit of its ideological objectives, the government frittered the funds away. The money went not into productive investment but into consumption to create a feel-good factor that paid high political dividends for the Conservatives in the second half of the 1980s, but was clearly unsustainable in the longer term. In fact the resources supplied by the North Sea helped to obscure the extent of the Thatcher government’s negligence and misguided macro-economic policies (25). Statistically the funds show up as private capital exports that brought no additional output or employment to Britain. All in all there was little to show for the North Sea Oil bonanza.

4. The key sector: manufacturing – output, investment, employment

For some decades the British manufacturing industry has performed badly as to output, productivity and employment, the range and the quality of its products and its contribution to the economy generally and to the balance of payments. It must be remembered that it was in Britain that the industrial revolution had begun in the last third of the eighteenth century and had then spread to Europe and that for a hundred years Britain was the "workshop of the world", until it was overtaken by Germany and the United States. In the early post-World War II decades, manufacturing remained the sector propelling the economy. From the 1960s and 1970s output and employment of the services sector began to grow fastest, as in all Western Europe, but what on the continent could be described as “tertiarisation”, the development of an increasingly services-based economy, turned into “de-industrialisation” in thatcherite
Britain. The questions that have to be addressed are the reasons for this
dismal performance and its significance for the economy as a whole and,
most relevant here, the role played by thatcherite policies.

Table 2:

<table>
<thead>
<tr>
<th></th>
<th>Growth of Manufacturing Output 1973–89 (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Britain</td>
<td>1,3</td>
</tr>
<tr>
<td>USA</td>
<td>55,2</td>
</tr>
<tr>
<td>France</td>
<td>16,5</td>
</tr>
<tr>
<td>Italy</td>
<td>68,6</td>
</tr>
<tr>
<td>Germany</td>
<td>32,1</td>
</tr>
<tr>
<td>Japan</td>
<td>68,9</td>
</tr>
</tbody>
</table>

Source: Kitson, Mitchie (1996 b) 32.

The basic facts are not in dispute. Over the last three decades, manufac-
turing output rose and fell in line with the economic cycle; product-
tivity grew in every year apart from the years 1975 and again 1980 even
when output fell; manufacturing employment declined almost conti-
nuously from its peak level in 1966 (8.6 million) to 3.9 million in the first
quarter of 1996 (26). Total output growth between the peak years 1973
and 1992 was 1.3% in Britain, while it was very much higher in the six
main competitor countries (between 17% and 69%) (Table 2). Between
1979 and 1989 it grew by an average 1.4% in Britain and then declined
to 1992. The data of Table 3 show the proximate reason for this history
of low output: net investment in manufacturing was in the 1979 to 1989
period no more than a fraction of that in the preceding two cycles,
whether expressed as (constant) pounds or as share of manufacturing
output. As a result, there was no growth at all in the capital stock, in
contrast to the experience of the main competitor counties (Table 4a and
4b) According to Kitson and Michie the capital stock gap is likely to
widen further, as through cumulative causation processes the expecta-
tion that the manufacturing sector is not investing become self-fulfilling
(27). The dismal investment record has been a major cause of Britain's
indifferent general economic growth, since it constrained technological
progress and the expansion of demand (28). Britain was the country with
the heaviest fall of manufacturing employment between 1979 and 1989
(Table 5). In the three peak-to-peak periods since 1964, Britain was also
the bottom of the league table in two of the periods and second bottom
in the third (29).

Manufacturing employment has fallen fastest in Britain because out-
put has failed to grow, and this because manufacturing capacity is too
small and what capacity there is tends to be insufficiently competitive;
these problems stem from the lack of investment, in skills and particu-
larly in capital equipment, and from the fact that most of the investment
that there was has been cost-cutting rather than capacity-enhancing.
Thus, while for the vast majority of OECD countries the growth rates of
research and development were much higher in the 1980s than in the
1970s, Britain was the most notable exception (30). Cost-cutting, labour
force (shop-floor supervisors and lower and middle management)
Table 3:
Manufacturing Net Investment in Britain (annual averages)

<table>
<thead>
<tr>
<th></th>
<th>1964–73</th>
<th>1973–79</th>
<th>1979–89</th>
</tr>
</thead>
<tbody>
<tr>
<td>million £ (1990 prices)</td>
<td>3614</td>
<td>2146</td>
<td>694</td>
</tr>
<tr>
<td>% of manufacturing output</td>
<td>4,0</td>
<td>2,1</td>
<td>0,6</td>
</tr>
</tbody>
</table>

Source: Kitson, Mitchie (1996 b) 37.

Table 4a:
Gross Capital Stock in Manufacturing (annual average growth of total assets, %)

<table>
<thead>
<tr>
<th></th>
<th>1964–73</th>
<th>1973–79</th>
<th>1979–89</th>
</tr>
</thead>
<tbody>
<tr>
<td>Britain</td>
<td>3,9</td>
<td>2,1</td>
<td>0,0</td>
</tr>
<tr>
<td>Germany, France (unweighted Ø)</td>
<td>7,1</td>
<td>3,4</td>
<td>1,7</td>
</tr>
<tr>
<td>USA, Japan (unweighted Ø)</td>
<td>9,2</td>
<td>5,1</td>
<td>3,6</td>
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Table 4b:
Gross Capital Stock 1989 ($, 1985 prices)

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>Per</th>
<th>Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>Britain</td>
<td>267</td>
<td>30,7</td>
<td>100</td>
</tr>
<tr>
<td>Germany, France (unweighted Ø)</td>
<td>437</td>
<td>41,3</td>
<td>134</td>
</tr>
<tr>
<td>USA, Japan (unweighted Ø)</td>
<td>1352</td>
<td>38,3</td>
<td>125</td>
</tr>
</tbody>
</table>

Source: Kitson, Mitchie (1996 a) 200 f.

Table 5:
Employment in Manufacturing (average annual change, %)

<table>
<thead>
<tr>
<th></th>
<th>1964–73</th>
<th>1973–79</th>
<th>1979–89</th>
</tr>
</thead>
<tbody>
<tr>
<td>Britain</td>
<td>-0,8</td>
<td>-1,3</td>
<td>-3,4</td>
</tr>
<tr>
<td>Italy, France, Germany (unweighted Ø)</td>
<td>2,4</td>
<td>-1,0</td>
<td>-1,8</td>
</tr>
<tr>
<td>USA, Japan (unweighted Ø)</td>
<td>1,8</td>
<td>-0,1</td>
<td>0,0</td>
</tr>
</tbody>
</table>

Source: Kitson, Mitchie (1996 a) 207.
“downsizing”, leading to a “boom in productivity and profits” on the other hand, and wage-freezes on the other – rather than product and process innovation – were, and remain, the preferred strategy of many of the large British manufacturing firms. Every day sees announcements of mass redundancies, even the closure of whole plants; the privatised (formerly public) sector alone has shed 650,000 jobs. It is only recently that it has begun to dawn – see the recantation of “lean production” and “re-engineering” gurus such as Stephen Roach of Morgan Stanley – that such policy reactions can be successful in the short run, but counter-productive in the long run (31).

So what was the impact of thatcherism on all this? Kitson and Michie (32) show how its macro-economic policy of high interest rates and the resultant over-valued exchange rate have badly affected manufacturing competitiveness and the high levels and volatility of interest rates damaged business confidence and so discouraged investment; excessive macro-instability, reflecting the government’s decision in 1979 to target nominal variables (inflation, interest rates) rather than real variables (employment and output), harmed the long-term growth potential by causing unnecessarily severe recessions. Their depth and length compounded the damage as capacity was reduced through massive “scraping” – when in milder and shorter recessions some surplus capacity might have been carried over. (See Section 7)

This was particularly damaging as the “industrial structure has shifted to more segmented and niche-product markets” which require specialist capital equipment and specialist skills, which are more difficult to replace. The (neo-classical) view of the competitive process, that price is the key indicator of competitiveness, has to be corrected: in the real world of firms facing few effective competitors, the key factors which contribute to competitive advantage are product quality and the establishment of a close and personal customer-client relationship and personal attention to client needs: these are not served by a bias towards cost-cutting and the “downsizing” of the managerial and specialised workforce. Kitson and Michie conclude that de-industrialisation can be a serious problem for the whole economy, that Britain’s industrial performance over the past thirty years has been poor, that neither the specific problem of de-industrialisation nor the consequent general problem of continued relative decline was solved in the 1980s and they confirm that the key reason has been under-investment in manufacturing.

Kitson and Michie also warn that “the idea that the British economy will be able to flourish internationally in the future in the absence of a strong manufacturing sector is yet another in a long line of short-term attitudes to Britain’s economic performance and prospects. To return to a position of full employment on a sustainable basis will require a dramatically better industrial performance than that witnessed since 1960 (or 1979). Indeed in many ways the situation has deteriorated since 1979”.
The analysis of the manufacturing experience of insufficient investment leading to insufficient capital equipment and insufficient economic growth also yields important insights into the consequent insufficient growth of employment and excessive growth of unemployment. Robert Rowthorn has documented how the low investment of the last two decades has been a significant factor in the rise of unemployment (33). (The productivity performance of manufacturing is analysed in Section 6.)

Generally, as to the causes of unemployment identified in economic theory: lack of aggregate demand was the "Keynesian" explanation of unemployment in the 1930s and thus post-war governments boosted private aggregate demand in many ways and, when necessary, supplemented it with additional public demand, and so achieved full employment. Lack of sufficient capital stock had been the explanation for ("classical") unemployment in nineteenth-century southern England (most industrialisation took place in the north) and in twentieth-century less-developed countries. The current conventional wisdom, the "neo-classical" explanation of unemployment (which informs, for instance, the OECD Jobs Study of 1994), sees persistent unemployment as mainly due to lack of flexibility of labour markets, combined with poor education and poor motivation, and the answer mainly in labour market deregulation. The assumption is that rigidities prevent the unemployed from getting work - on existing capital stock - and existing capital stock is also posited by the "natural" or "non-accelerating" inflation rate approach to unemployment. In contrast to this current fixation on labour market issues, Robert Rowthorn (34) and Jonathan Michie and John Grieve Smith (35) focus on what is surely a more commonsense approach, namely that investment in new productive capacity creates jobs, while destruction of existing capacity destroys jobs and that thus much of the unemployment of the last twenty years in the UK (and in Western Europe generally) is explained by the low level of investment, especially in manufacturing and other tradables. This harks back to the concept of "classical" unemployment or, more precisely, is an application of it - this time to the situation of advanced industrial countries.

Rowthorn also argues, and tests his approach empirically, that capital shortage can manifest itself not only in unemployment but also in pronounced earnings inequality. So in addition to its positive effects on employment - the contributions to the Michie and Smith book are devoted to an analysis of the British case - increased investment would also in Rowthorn's view help to improve the position of many people whose relative earnings are depressed by a lack of "good" jobs, particularly in Britain (and the US) "where a large fraction of the labour force is crowded into badly-paid jobs" (36). So while premature scrapping and inadequate investment in manufacturing manifest themselves in the form of lower employment, low investment leads in addition to a shortage of good jobs in deregulated economies (as in the UK), where there is a much larger secondary labour market and benefits are less generous. "Those left out", it is claimed "will be forced to accept badly-paid jobs
in the secondary labour market [and] the resulting competition will push wages down even further in this market, creating still more inequality.”

The whole question of the British investment performance, discussed above, has recently been the subject of wider attention. Stung by widespread criticism of the policies that had led to, or did not prevent, the massive under-investment experienced by the British economy, Treasury Chief Secretary William Waldegrave stated that “there are a lot of myths about investment. In fact, it is a British success story” (37). Stephen Bond and Tim Jenkinson assessed British investment performance and policy by presenting cross-country evidence from Japan, Germany, France, Italy, the US and the UK for the period 1980–1993. Countering claims made in a recent Department of Trade and Industry statement, they conclude that Britain has invested a lower share of Gdp than any of these countries, as to gross investment, gross investment excluding residential construction and equipment (38).

5. Inward foreign direct investment

Almost the only good news regarding the performance of the manufacturing sector comes directly and indirectly from inward foreign investment from which Britain, which has a higher ratio of it to Gdp than any other leading global economy, has benefited greatly: it has shaken up the industrial scene by being an important force for competition, restructuring, the introduction of higher-quality products and the transformation of production and work practices. David Currie calls it a catalyst for dynamism and change (39). Attracting foreign investment was and remains the Thatcher/Major governments’ substitute for an industrial and regional policy. There has long been an important US presence in British industry, but recent years have seen a strong influx from Germany (almost 300 firms) and from the Pacific Rim, amongst them no fewer than 180 Japanese ventures. In the year to April 1995, the government recorded 477 new investment projects, directly creating nearly 50,000 jobs. Since 1979 the government estimates that more than 800,000 jobs have been created or safeguarded by inward investment, all of which is targeting the British market, but in particular the EU market as a whole. Many have chosen Britain because they are comfortable with the English language – American being the lingua franca of international business and technology (40). Britain also has one of the lowest rates of company taxation in the EU and permits international managers to pay their own national income tax rates, at least for a time. According to Walter Eltis, they are also attracted by the open and deregulated economy and by the good labour relations environment (41), though this is surely no better than that of many other EU countries. Foreign firms also, the Japanese firms in particular, are creating their own co-operative workplace environment. What is not mentioned usually is that there are very generous financial inducements and frequently tax holidays.
available; it is customary for firms to play off against each other Britain's competing regional development institutions and also those of the rest of Europe. The "intense and probably counter-productive" (42) rivalry was demonstrated in connection with the recent decision by LG Electronics to build a £ 1.7 plant in Wales.

The quantitative and qualitative significance of the foreign firms' contribution can be glimpsed in the 1992 Census of Production: foreign-owned companies accounted for 17.9% of manufacturing employment in Britain, 23.4% of value-added in manufacturing, 31.6% of manufacturing investment and, according to Eltis, 35–40% of manufacturing exports (43). By 1995 Britain's stock of inward direct investment stood at more than £ 150 billion (44). Their management compares favourably with that of – often indifferent – British management and has had a positive influence on it, forcing competitors to adapt, but it is also felt "upstream" in the immense network of suppliers of components, the quality and reliability of which had to be greatly improved to satisfy the more demanding requirements of the foreign firms. These firms have also introduced some of the most advanced products and processes and their investment is high compared with British investment (it has trebled as a proportion of total investment since the early 1970s); even more significant, it tends to be of the "enterprise" rather than the "defensive" kind towards which British industrial investment is too often biased. Outstanding examples are consumer electronics and car-making. This is almost entirely in American, German, Japanese, French and Korean hands and has fundamentally transformed the assembly and component industry by "green field" investment or by the takeover of long-standing British firms. Between 1988 and the present, car-related exports have trebled and reversed the large and increasing car-related trade deficit that had in the mid-1980s arisen for the first time in British history.

A European Commission working paper suggests that, while foreign direct investment into the EU may be driven in part by the attractions of low real wages and by potential market growth, differences in labour market regulations can also be an important factor because of its impact on costs and flexibility. On the other hand, these potential "advantages" may not always be exploited in practice since multinational enterprises generally prefer to offer similar working conditions and arrangements across Europe rather than differentiate between member states (45). As to the comparatively low direct and indirect wage costs in Britain: according to the Financial Times Survey (46) these are "increasingly less critical" given the high-tech, capital-intensive nature of many new investments.

In any case, continuing to attract foreign direct investment demands an improvement in British public investment in the long-neglected physical and human infrastructure: the Financial Times Survey speaks of a "worrying skills gap" across the board which needs to be closed (47). The government's recent "Skills Audit", which forms the centrepiece of the
third Competition White Paper (48), confirms this: it shows that in this respect the British workforce has slipped further behind its main economic rivals in Europe and overseas (49).

The record of foreign direct investment is truly impressive and the policy of attracting foreign firms will surely be maintained: these firms show the superiority of a high-wage and associated high-skill labour force and high-quality approach over the increasingly prevalent mind-set that believes that Britain’s competitiveness can be improved by low wages (the “Hong Kong” syndrome) and the associated low skills of the workforce which implies low-quality products.

Currie also warns that the ambivalence of British government policy towards the European Union, which increasingly threatens to sideline Britain in Europe may prove to be ill-advised (50) if inward investment is to be encouraged. That warning was given well before the government antics connected with the BSE crisis, which is really outside consideration here, except for the fact that it provides evidence of the strength of the political forces (inside the Conservative establishment and the conservative press) hostile to the European project, ignoring the true interests of Britain and its economy. In addition, there is the fact, which a progressive Catholic weekly notes as a “widespread conviction in Europe” that the spread of BSE via infected feed was only possible “given the excessive deregulation characteristic of the new liberal experiment being pursued in Britain” (51).

6. Productivity

If the growth of the British economy resumed – however modestly and briefly – in the later 1980s, this is due to a resumption of productivity growth after the interruption of the mid-1970s, at least in manufacturing and mining; in services little improvement can be discerned. A “productivity miracle” is widely claimed by government to have been an outstanding economic achievement of the supply-side and deregulation policies of the Thatcher decade. The statistical outcome of massive redundancies and an only modest recovery in output that followed the great melt-down of manufacturing in the first two years of the Thatcher government is an increase in productivity by 4.7% a year. Most other countries with substantial productivity growth achieved quite rapid output growth, while most with stagnant output growth tended to show low productivity growth (52). In Britain productivity advances have also not been underwritten by investment, leaving the capital stock not much changed over the decade in spite of sharply rising profitability. This is due to the damage done to confidence by the poor macro performance.

Not surprisingly, the contradictory British productivity experience has attracted a large number of academic studies. They have found evidence of improvement but the reasons for it remain in dispute. Some have relativised the achievement, and some have doubted its durability.

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Tables 6 to 9 set out a selection of the relevant data. The picture is one of post-1979 productivity growth well above that of the later 1970s. However, productivity growth in the sixteen Thatcher years remains inferior to that of the thirteen pre-Thatcher years, sometimes substantially so. The most recent authoritative survey of studies concludes therefore that the productivity picture is one of recovery rather than improvement (53), and in its title asked the rhetorical question: "What happened to the miracle"? After the 1980s, productivity growth in manufacturing slowed down again. In the four years of the early 1990s it was 13% lower than in the 1980s and fell further, from 3% in the first quarter of 1995 to 1.5% in the second and to 0.7% in the third, and was actually negative in October (output per head basis). It also fell for the whole economy from 3.3% in 1994 to 2.3% in the first half of 1995 (54).

In the 1980s Britain's productivity grew faster than that of Western Europe, but not because of improvement in Britain but because of deterioration in Europe: another case of "catch down". And the level of productivity in "deregulated" Britain remains well below that of the more "regulated" economies of Western Europe, a fact that is admitted by the government (55) in successive Competition White Papers.

Even so, there was improvement. Can improvement in productivity be automatically equated with improvement in efficiency? The government underlines the link between changes in productivity, competitiveness and living standards (56). But, as we have seen, in Britain the recovery of productivity has not been reflected in the level of output, but was to a large extent a reflection of huge and sustained job losses. A higher level of output would have made an unambiguous case of improvement in real efficiency of the economy. In fact the evidence points in the opposite direction (57).

The government, but also some analysts, see the productivity recovery - modest though it was - as the pay-off for having reduced the influence of the trade unions by punitive legislation and a consequent improvement of the industrial relations environment. Some claimed that the "get-tough" approach to the unions had yielded significant benefits for the economy. Workers had been "disciplined" in the early 1980s by the exceptionally harsh conditions in which manufacturing firms collapsed and unemployment was a growing threat. Management succeeded in demanding and getting higher levels of work effort and productivity. Against this view of the success of macho-management and macho government, the conclusion that emerges from the contributions to "Industrial Relations", a highly authoritative collective work of industrial relations and management specialists, is that the Thatcher reforms might be promoting short-term gains at the expense of more fundamental reforms, including urgently-needed investment in plant, people and technology (58).

There is no theory support for the claim that strong unions are an obstacle to improved work practices and enhanced productivity, and much British and international experience points the other way: a group
Table 6:

Growth of Labour Productivity in Britain
(output per person employed, average annual growth rates, %)

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<tbody>
<tr>
<td>Manufacturing</td>
<td>3,4</td>
<td>3,9</td>
<td>0,6</td>
<td>3,7</td>
</tr>
<tr>
<td>Private Services</td>
<td>n.a.</td>
<td>n.a.</td>
<td>1,7</td>
<td>2,3</td>
</tr>
<tr>
<td>Whole Economy</td>
<td>2,8</td>
<td>3,1</td>
<td>1,2</td>
<td>1,9</td>
</tr>
</tbody>
</table>


Table 7:

Productivity in British Manufacturing (average annual % change)

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</thead>
<tbody>
<tr>
<td>Labour</td>
<td>4,6</td>
<td>1,7</td>
<td>1,4</td>
<td>3,8</td>
</tr>
<tr>
<td>Total Factor</td>
<td>1,2</td>
<td>-1,6</td>
<td>-1,0</td>
<td>1,3</td>
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</tbody>
</table>


Table 8:

Productivity in the British Business Sector (average annual % change)

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<tbody>
<tr>
<td>Labour (output per person employed)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Britain</td>
<td>3,9</td>
<td>1,5</td>
<td>3,1</td>
<td>2,0</td>
</tr>
<tr>
<td>Europe (16 OECD members)</td>
<td>5,1</td>
<td>2,6</td>
<td>4,3</td>
<td>1,8</td>
</tr>
<tr>
<td>Total Factor</td>
<td>2,6</td>
<td>0,6</td>
<td>2,0</td>
<td>1,5</td>
</tr>
<tr>
<td>Britain</td>
<td>3,3</td>
<td>1,4</td>
<td>2,7</td>
<td>1,0</td>
</tr>
<tr>
<td>Europe (16 OECD members)</td>
<td></td>
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Table 9:

Productivity in Manufacturing
(average annual % change in output per hour)

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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Britain</td>
<td>4,1</td>
<td>1,0</td>
<td>4,1</td>
<td>4,0</td>
</tr>
<tr>
<td>Germany</td>
<td>5,7</td>
<td>4,2</td>
<td>1,8</td>
<td>2,2</td>
</tr>
<tr>
<td>B, F, NL, I (unweighted Ø)</td>
<td>6,6</td>
<td>5,3</td>
<td>3,7</td>
<td>3,4</td>
</tr>
</tbody>
</table>

of Harvard labour economists concludes that "unionism per se is neither a plus nor a minus for productivity. What matters is how unions and management interact" (59), but they emphasise the potential efficiency gains resulting from the presence in the work-place of trade unions who provide an effective collective "voice" mechanism (60). We also know that strong unions operating in a consensual labour relations framework play a strong and positive role in technical and organisational innovation and improved work practices. Arguably very low British productivity levels in the second half of the 1970s arose, not because workers resisted improvements, or caused levels of wages to be too high, but, on the contrary, it was low pay that made it less attractive for manufacturers to invest in capital-intensive methods (61).

Kitchen and Michie (62) are even more critical of the productivity record; they describe the picture of a productivity miracle during the 1980s as a mirage, since the OECD data on productivity are unreliable, as they are constructed using an inappropriate "single price-deflator for both output and input prices", and so significantly overstate productivity growth as having amounted to 51% between 1979 and 1989. Stoneman and Francis re-worked the official productivity series for this period, using more appropriate "double deflation accounting" and found productivity growth to have been 34% only (63). This refers to "labour" productivity; as to Total Factor Productivity, while OECD results suggest a 1.3% increase between 1979 and 1986, they find only a 0.2% increase, partly due to "unrealistic assumptions" on which the construction of the measures are based. That would in fact make the UK performance not the best, but the worst of the countries compared by the OECD (UK, US, Japan, France and Germany). They argued in addition that, far from paving the way for genuine productivity improvement, the government policies of deregulation and anti-trade union legislation impaired effective labour utilisation and competitiveness in product markets (64).

Finally, in the 1980s the benefits of productivity growth went overwhelmingly into cutting costs and employment, rather than into developing new products and expanding output. In an interesting paper, Andrew Glyn has shown in detail how these benefits from the productivity increases between 1979 and 1989 in manufacturing were distributed: those outside the industry benefitted from modestly-falling relative prices of manufactures as consumers, and incurred losses as tax-payers in supporting the many hundreds of thousands who were made redundant (26% of all workers employed had lost their jobs); of course they did not share at all in the benefits. Losses were greatest for those who remained unemployed, smaller for those who found work later in other – lower-wage – sectors. Those who remained in employment saw wage increases of 28% over the period, but they paid for it with greater intensity of work. Shareholders incurred no losses, and experienced the highest benefits: their dividends rose by 73%, the value of their shares by 125% (65).
7. Poor macro policy and performance

While it is generally accepted that the British 1979–83 recession, here defined as the number of quarters (sixteen!) it took for output to regain its previous peak level, had been aggravated by policy mistakes, Nicholas Oulton shows that the depth and severity of the 1990–94 recession (fifteen quarters) were entirely home-made. He points to the decision to enter the ERM in October 1990 at the greatly over-valued central rate of \( £ 1 = 2.95 \) DM and to the over-expansion of demand and credit in the later 1980s (the “Lawson boom”) (66). This was (though, not surprisingly, Lawson – Chancellor at the time – has always denied it) not unconnected with the need felt by the Tories to create a “feel-good factor” in the run-up to the (1987) general election.

His empirical work shows that, in the 1980s and early 1990s, out of fourteen countries ranked according to the growth rate of their Gdp, Britain came tenth. It had the sixth highest “variance” of the growth rate and the second largest degree of “skewness” – both measures of instability that tend to be associated with low growth rates, and Britain spent forty-eight of the last hundred quarters in recession, the second poorest. Not surprisingly Oulton concludes that the “UK's [macro] performance is amongst the worst” of OECD countries” (67).

8. Public finance and taxation

The reform of public finance has from the start been at the heart of the thatcherites economic and societal strategy: reducing public expenditure accorded with their ideological predilections of reducing the economic role of the state, but also because they continued to be convinced that government “crowds out” private sector activity and so reduces economic growth. Public expenditure cuts also allow for tax cuts which (in the new dispensation) support economic expansion, as it acts as an incentive, not because (à la Keynes) it increases purchasing power and so demand. Referring to themselves as the party of “low spending and low taxation” the Conservatives continue to depict the Labour Party as “the party of high spending and high taxation”. As an election ploy, this has, at least up to now, paid high political dividends, but it has no foundation in fact.

According to the government – and to Mrs. Thatcher – the reform of public finances has been achieved and has been beneficial: public expenditure has been reduced, taxes cut and public borrowing reduced (68). The historical record does not bear out these claims to any meaningful extent.

In the first place, no clear link can be shown between political party and level of the tax burden: a chart based on government data shows that under Labour it rose to about 38% of Gdp in 1969, and fell steadily – again under Labour – between 1974 and 1978 to below 35%. It rose un-
der Mrs. Thatcher to nearly 40% by 1981, then fell slightly (but never below Labour’s last year) and then rose again in 1994 and 1995 to about 38% (69).

The Chancellor of the Exchequer for much of the 1980s has himself admitted that the Conservative governments had indeed not reduced the burden of taxation (either absolutely or even as a proportion of Gdp) and that in 1991/92 it was actually two percentage points higher than in the last year of the Labour government, 1978/79 (70). The choice of the 1991/92 date is significant: 1993 saw “one of the largest packages of tax increases in living memory” (71). But what the Conservatives had done was to create an optical illusion: the “progressive” and eye-catching income tax rates were lowered while the highly regressive – but almost invisible – Value Added Tax rate was more than doubled. There has also been a clear tilt in the balance: people in the bottom seven-tenths of the income distribution were paying more, the top tenth less, tax in 1994/95, than before the Conservatives came to power (72).

As to public expenditure, it corresponded to 39% of Gdp in 1990, then rose year by year to 44.5% in 1994. This compares with roughly 35% in the “socialist 1960s” (73). Of course the “level” of public expenditure is not uniquely what matters even though it is the datum put into the centre of political attention by the Conservatives. Arguably, what matters most is how the money is spent. Under the Conservatives what rose inexorably – and upset plans for “good housekeeping” and for fulfilling election promises of lower spending – was that part of the social security budget allocated to supporting people who could not make ends meet as a consequence of government policies or the lack of them. There were the unemployed but also the “working poor” whose wages were too low because boards setting minimum wages in some employment sectors have been abolished, or because part-time and therefore part-pay, employment became an ever-growing proportion of total employment. What was drastically reduced was public expenditure on investment. The delapidated state of many hospitals and schools, of inner cities, of the road and rail network, is a stark reminder.

The statistical expression of all this is a substantially worsened balance between public sector assets and financial liabilities, in spite of a short-sighted, in the long run expensive, policy of penny-pinching, in the pursuit of an elusive and anyway frequently socially malign reduction in public expenditure. When Mrs. Thatcher took office, physical assets exceeded financial liabilities by a year’s Gdp. This was the result of steady falls in net financial liabilities and a steady rise in the value of publicly-owned assets since 1957. After 1979, the picture changed dramatically. Net investment collapsed as government capital spending bore the brunt of budgetary cuts; assets were sold through privatisation, but financial liabilities grew: by 1992 the physical/financial balance was only equivalent to less than half a year’s Gdp: such a deterioration could at some point become unsustainable (74).
A particularly troubling outcome of the expenditure/taxation issue is that the neo-liberals seem to have succeeded in turning it into a beauty contest between the political parties as to who will tax less and spend less, suggesting that taxes are bad per se and debating the issue in terms of public expenditure only, and not at all in terms of the public services which are provided and financed by taxation.

9. Tory “social engineering”

In the thatcherites’ self-understanding and in the way they wished to be seen by others, the pursuit of low public expenditure and the proper stewardship of public resources was paramount; but as a matter of Realpolitik fiscal virtue was always balanced by political prudence: loosening the tight rein appears to have been justified in the run-up to elections. (This was clearly so before the 1987 and the 1992 elections and may be so again in the run-up to 1997). More generally, the economics and politics of the privatisation process are particularly instructive. Privatisation responded to a deep ideological urge among thatcherites but the actual trigger to ever-wider sales of state assets was the need to raise revenues (75), without raising taxes or increasing public borrowing. (The word “privatisation” did not, for instance, even figure in the key 1979 election manifesto of the Conservative Party, since an “extensive catalogue” of firms to be sold off “might frighten the floating voter”) (76).

However, for Mrs. Thatcher, the desirability of maximising such revenues for the budget had to be tempered by the requirements of her instincts for “social engineering”: to create a property-owning democracy that would be a Conservative-voting democracy, potential purchasers had to be bribed into buying shares in (public) enterprises which they had believed they already owned: the shares were sold so much below their market value that in almost every case the issues were massively over-subscribed. The lucky winners found that immediately on official dealing on the Stock Exchange the share price jumped far above the subscription price, thus guaranteeing an instant profit to personal and institutional shareholders; the losers were the public finances – ultimately the tax-payers to the tune of many billions of pounds. Another set of losers were the employees of the privatised enterprises: in the first ten years of denationalisation, 650,000 lost their jobs (77), while managers were richly rewarded.

In the case of the first British Telecom sale in December 1984, the premium was more than 80% and in the British Airways sale of February 1987 approximately 100%. Before the thirteen largest firms were sold, the government first wrote off a total of £ 22.5 billion in debt owed to it – and so to the taxpayer (78). A further nearly £ 3 billion was scheduled to be added to this in connection with selling the railways. When the nuclear power industry was sold off in 1996 the price paid for six power stations was less than the cost had been of building the latest one and the
high financial burden of the eventual decommissioning of plants remains with the government. To gauge the significance of these sums, one must note that total official privatisation revenues totalled £ 55 billion up to 1993. There were other sweeteners handed out in this context: privatised firms such as water companies and the railways often own extensive plots of land that are highly valuable once they are used or sold for commercial development, but this does not show up in the sale price. Interestingly, “give-away privatisation” has not led to a share-holding boom, on the contrary: the number of individual shareholders has, between 1992 and 1996, fallen (from 10 million to 9 million), half of them have shares in only one or two (mostly privatisation) companies. The combined value of individual shareholdings has dropped from 28% of the total traded on the London Stock Exchange in 1981 to 20% in 1996 (79).

To increase the number of owners of housing property, council house tenants were given the right to buy the homes they were renting and councils were prevented from building new homes for rent. The rationale behind this project (80) is partly based on ideology but also on direct electoral advantage. In the 1983 election, owner-occupiers had voted 3 to 1 Tory, council tenants 2.5 to 1 Labour (81). Ironically, to carry through the policy of forcing local authorities to sell council houses to their tenants, Mrs. Thatcher had to go against three of her proclaimed principles. She had to “nationalise” the council house stock first, as it belonged to individual authorities, she rejected market pricing and insisted on up to 60% discounts on the real value. In addition, prospective home purchasers did not pay market interest on the money they borrowed from the building societies and banks to finance their acquisitions: they received “mortgage tax relief”.

The overall financial effect was that real net current spending on council housing and (mostly subsidised) rent fell over the decade from £ 3.5 billion to £ 1.4 billion at constant prices, but as rents were forced up by the government – partly by reducing funds to councils, (means-tested) housing benefit rose from £ 1.8 billion to £ 3.6 billion. If there is such a thing as a “dependency culture” developing in Britain, as ministers regularly bemoan, here is how the government has actually encouraged it.

Mortgage tax relief applied of course equally to the most extensive, and most expensive project of Tory “social engineering”, the subsidising of private home ownership generally. The many-billion pound cost of this to the public finances is so high that it was a constant element of friction between her and the Treasury ministers who, as guardians of the public purse, wanted to adhere to what were supposed to be the thatcherite principles of deregulated markets and freely determined prices, and to limit, reduce, or fully abolish such tax privileges (82). These were, of course, generally available to the better-off only.

Revenue from sales of council houses could rarely be used for improving the remaining (often badly run down) housing estates and it could certainly not be used for building new homes, although the shortage of
housing is now beginning to assume catastrophic proportions: the central government kept full control of the revenues raised.

On capital account, support for the building of council and housing association homes fell from £ 5.3 billion to £ 1.3 billion while tax relief (not means-tested) to owner-occupiers rose from £ 2.6 to £ 5.2 billion. Overall financial results thus remained roughly unaltered, but what had happened was a massive social shift. Simon Jenkins sums up Mrs. Thatcher's changes in housing policy as follows: while ending "housing's central role in the Welfare State" she had elevated it "as an engine of middle class thrift" and "despite the impact on public spending brought it firmly under central control" (83).

The overall administrative consequences were a further reduction in the functions of elected local councils accountable to their electors and the creation of unelected, unaccountable institutions (housing associations and similar agencies unconnected with local democracy and almost entirely financed by "quangos" (quasi-non-governmental organisations) directly appointed and funded by the central government which thus acquired total financial and political control. (See Section 17). This was the very opposite of the claim, regularly repeated, that thatcherism had "rolled back the state".

10. 1992: a new economic strategy?

Events in 1992 brought fundamental change. In the course of a few months, the government's economic strategy collapsed: the policy, which had been overly restrictive, became strongly expansionary. The name of the game was no longer disinflation but, as it had been in the "bad old" pre-Thatcher years, so despised by the thatcherites – but economic growth and the creation of jobs. Speaking to senior political journalists on 20 October, Mr. Major said that he would henceforth (!) pursue a "strategy for growth" (84), and Mr. Clarke, the newly-appointed Chancellor of the Exchequer, said on 9 June 1993 that what it was all about was "growth and employment" (85).

In fact, what followed was the most successful economic scenario in decades, a "textbook" re-balancing of the economy: devaluation combined with low inflation promoted an export-driven recovery of output, and it was achieved not by the dogmatic application of monetarist or other thatcherite nostrums, nor of the minimalist vision of Lawson's Mais lecture: these had failed again. It was steered by a traditional, dare one say, Keynesian-type pragmatic mix of fiscal and monetary policies.

But one should not get carried away: the various performance indicators still remained relatively poor and – perhaps more ominously – the character of the recovery soon reverted to the earlier, less successful model. The output level of mid-1990 was not reached again until 1994, the output gap was then still 3% of potential Gdp, employment remained 5% below its cyclical peak, unemployment, though falling, still averaged 8.4% in 1995, even on the (misleading) official count. Increases of real
compensation to employees in the business sector averaged 0.4%. Continuing an unfortunate tradition, the upturn of output was not accompanied by an equivalent upturn in private investment in human and physical capital or in public investment in human and physical infrastructure. Accordingly, productivity growth slowed down dramatically.

A leading article in the big business daily Financial Times at the end of April 1996 expressed it thus: the UK economic recovery was supposed to be different from the previous ones. Export-driven manufacturing was to be in the van, supported by strengthening public finances, weak consumer demand, sluggish monetary growth and low inflation. That was indeed the happy story in 1994. Now, however, weak exports, buoyant consumer demand, soaring monetary growth and feeble public finances – all the old spectres – are back. Much of the manufacturing and manufacturing export recovery occurred in a glorious, but short-lived burst between the Autumns of 1993 and 1994. Output has not increased further since November 1994. Even though there has been rebalancing between the domestic and export sales of manufacturing, a similar rebalancing has not occurred in the economy as a whole. The pattern of the recovery has changed since the beginning of 1995, with domestic consumption and Gdp rising significantly more quickly than manufactured output and exports. Fiscal policy is significantly looser than had been expected, with public sector borrowing requirement £ 32.2 billion in 1995/96 (4.5% of Gdp) as against the £ 21.5 billion (3% of Gdp) forecast less than eighteen months ago.

Meanwhile the Chancellor’s cut in the base rate of interest will stimulate domestic demand rather than exports, since the trade-weighted exchange rate has recently been steady overall (it had fallen sharply in 1992). With a further tightening of fiscal policy inconceivable before the next election, the probability must be a combination of strong domestic demand with a weakening external balance. This threatens first the exchange rate and ultimately inflation. The one escape from this trap would be a supply-driven expansion of manufactured exports. Here the depressing fact is the dismal performance of fixed capital formation in manufacturing. It is well below levels reached in 1988 and 1989. The capacity now being put into place is unlikely to be enough to produce the needed expansion in export supply (86).

What is most significant about the original, at first positive, turnaround is that the favourable conjuncture was not the result of an intended change in economic strategy. On the contrary, change was strongly resisted and was forced on Mr. Major’s government as its intended policy collapsed in a welter of economic defeats, political recriminations, broken promises and damaged political reputations.

The intended policy had been the pursuit of an anti-inflationary strategy by way of pegging the value of the pound to that of the Deutsche Mark. In the ill-fated “Lawson boom” of the later 1980s the government had had, once more, lost control of inflation. By 1990, the rate of increase of consumer prices had reached 9.5%. In order to rebuild the credibility
of its policy, the government had joined the ERM of the EMS, choosing – against the advice of the Bundesbank – the over-valued rate of 2.95 DM to the pound. To maintain this central parity, interest rates had to be raised to levels so high as to be wholly inappropriate for the cyclical position of the British economy, which had begun to slide into recession in the first half of 1990 and reached its cyclical trough early in 1992. Eighteen months after joining, it had become obvious that the fierce disinflatory squeeze threatened to turn the recession into a slump. But the government, having elevated a specific parity into a symbol of its economic and political competence, stubbornly refused to rectify the original error by devaluing inside the ERM; when the weakness of the pound sterling became evident and speculative pressures for devaluation mounted inexorably in the Autumn of 1992, John Major repeatedly raised the political stakes in defence of the actual rate, insisting that the parity of the pound in the ERM was the immovable cornerstone of the government's economic strategy. On 16 September 1992, the pound was forced out of the ERM and the Prime Minister had “ensured that when the defeat came it was devastating” (87), leaving the government without a viable economic strategy and with its reputation for competence badly damaged.

What had compounded the error of attempting to maintain an over-valued exchange rate was that Britain was particularly vulnerable to the downside of an otherwise beneficial high exchange rate, as British competitiveness appears to be (in contrast to such traditional and successful hard currency countries as Germany, Switzerland and Austria) excessively based on price, rather than on quality and service, factors. It is also difficult to see how a hard currency policy could have been succesful and acted as a spur to productivity and structural change in a political climate in which the government persisted in its obsessive hostility to the trade union movement and in which the positive potential of meaningful co-operation and compromise between social partners was dogmatically ignored, even sabotaged.

Mr. Major had broken his promise made before the 1992 elections to tame inflation by maintaining the pound’s parity inside the ERM. To pay for the consequences of the recession and for having lowered fiscal discipline before the election (the forecast for public borrowing was now for a “staggering” £ 50 billion) (88), he was then forced to break a further promise, that of reducing taxes. In the March 1993 Budget the “largest package of tax increases in living memory”, amounting to over £ 10 billion, was imposed and a further £ 5 billion were added in the Autumn of the same year (89). “Creative accounting” managed to hide the full import of the increases but they were later estimated to have been equivalent to an addition of seven pence in the pound on the standard rate of income tax (90). Over the whole Thatcher period, the direct tax rate had been reduced by eight pence, amid great publicity and self-gratulation. What was left was a mere one pence reduction in the direct rate, while at the same time indirect taxation had been massively increased. (In the last but one Budget before the elections scheduled for 1997, the direct
tax rate was reduced by one penny and, in spite of the difficult state of the public finances, voters were given reason to anticipate further eye-catching reductions in the last pre-election Budget).

The irony is that it was the two broken promises and the abandonment of thatcherite macro-economic policy that combined to bring about, however briefly, a "perfect", an "economist's" cyclical recovery: domestic demand remained low because of the squeeze on real incomes of consumers and a ten billion pound reduction in public expenditure, while foreign demand expanded: leaving the ERM led to a "competitive devaluation" that at one point reached 23% against the DM or 16% of the "effective" rate. Inflation was held back not only by world-wide processes but also by the downward pressure exerted by weak employment markets, the crash in house prices, depressed consumer confidence and the high level of spare productive capacity and unsold and unsellable stocks: inflation which had been brought under control by the link with the DM/ERM, stayed low not because of the strength but of the weakness of the economy. The "economic" success of the early post-ERM years, while bringing high profits to business, did not filter through to the mass of individuals. Two data say it all: between 1991 and 1995 labour's shares of national income (business sector), declined by 4.9 percentage points (91); and since 1992 nearly nine million people have experienced at least one spell of unemployment (92). It was and remains a "joyless" recovery.

The political consequence of this was that voters, "sore" and "disillusioned by recession" which had been policy-made – were "outraged" by the broken promises and had lost not merely confidence in the pledges made by the Conservatives, but also in their competence in managing the economy (93), traditionally perhaps their most valuable political asset. Opinion polls showed the collapse of the government's popularity and in the partial local elections of 1993 the Conservatives lost control of all but one of the "shire councils", the traditional bedrock of their support. Perhaps more important, they lost five hundred council seats, and as it is local councillors who provide the core of their activists in general elections also, this was a bitter blow. In the partial local elections of May 1996, the Conservatives suffered a further defeat: they lost more than half their seats. In summing up the situation, Stephens states that the favourable economic conjuncture "offered little political comfort to John Major". The government never apologised for the ERM débâcle on Black Wednesday nor for the volte-face on taxation and "unsurprisingly, the voters chose not to assign to it the credit" for the improvement in the economy (94). This must have belatedly dawned on the government because, in May 1996, the Conservative Party launched a poster campaign which referred to the unpopularity of the effects of their economic policy with the slogan, "Yes it hurt, but yes it worked". (They were harking back to a statement by a former Chancellor of the Exchequer who said of the government's economic policy, "If it isn't hurting, it isn't working"). Clearly the Tories wanted to turn away wrath by confessing that they had caused pain and at the same time to be rewarded for not having flin-
ched from applying bitter medicine so as to cure the recent bout of inflation, the deep recession and to “having had” to increase taxation. In fact, they were not coming clean, as they did not explain that these problems which had needed solving had been caused by their own policies, or absence of policies, in the first place.

Notes

(4) Thatcher 11 January 1996.
(7) The word brought together the name of prominent Conservative Rab Butler and of the later Labour leader Hugh Gaitskell.
(9) Roll (1994).
(12) Hayes (1994) 84.
(22) Lawson (1992) 414 f.
(23) Deputy Prime Minister Heseltine in an interview on Radio 4, 2 April 1996.
(27) Kitson, Michie (1996b) 41.
(28) Kitson, Michie (1996b) 40 f.
(29) Kitson, Michie (1996b) 31.
(30) Kitson, Michie (1996b) 30 ff.
(44) Financial Times 18 July 1996.
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